



Raising the Bar on Human Rights

What the Ruggie Principles Mean for Responsible Investors

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EXECUTIVE SUMMARY

In June 2011, John Ruggie, United Nations Special Representative on Business and Human Rights, presented to the UN Human Rights Council his *Guiding Principles on Business and Human Rights: Implementing the United Nations “Protect, Respect and Remedy” Framework*,¹ the result of his six-year study on business and human rights. Building on his “Protect, Respect and Remedy” Framework, released in 2008, the Principles outline the state’s duty to protect human rights, the corporation’s responsibility to respect human rights, and the need for access to remedy. On June 16, in an unprecedented step, the UN Human Rights Council unanimously endorsed the Principles.

Investors stand to benefit from the Principles, which can be used to support the implementation of responsible investment (RI) strategies, including active ownership and various forms of ESG integration. More specifically:

- They provide a robust, authoritative framework upon which to build RI investment policies and due diligence management systems that address human rights;
- They provide a framework for assessing the human rights policies, management systems and performance of individual companies in an investment universe;
- They provide practical guidance for active ownership, through engagement and proxy voting, on human rights issues.

The Principles can serve as a tool for risk management, providing an early-warning system to assess high-risk companies or operations, and as an approach to dealing with human rights dilemmas when they emerge. Implementing Ruggie's Principles can therefore help to prevent or mitigate the operational, legal, and reputational risks that institutional investors may face due to human rights issues.

The Framework and the Principles have provided much needed clarity regarding the respective roles of the state and business in protecting and respecting human rights. Ruggie's work illustrates the inconsistencies that exist in many countries between human rights policies and policies that directly govern business practices, resulting in an accountability gap. The Principles call on states to fill that gap.

With respect to business, the Principles counter the traditional view of many in the corporate world that human rights are a concern of the state and not of business. They suggest a new level of responsibility for companies and they emphasize a pro-active due diligence approach that puts the onus on companies to adopt policies and implement management systems that will enable the effective management of human rights issues. A great benefit of the Principles is that they provide practical recommendations as to how companies and investors can do so.

Any new regulations emerging in response to Ruggie's call might be construed by some businesses as a new source of compliance costs as well as risk. However, in Sustainalytics' view, the effect of regulations in line with the Principles will be to reduce risk. It is in every company's interest to protect human rights and to effectively manage human rights risk, and sound national-level policies and regulations will assist companies in doing so. As Ruggie notes, the Principles are "an inter-related and dynamic system of preventative and remedial measures"; they have the potential to mutually reinforce the human rights-related initiatives of both states and corporations in a manner that is advantageous to all.

It is critical to note that, like any set of principles, Ruggie's work will be effective in practice only to the degree that the key actors – states and businesses – implement the principles. As concerned non-governmental organizations (NGOs) rightly point out, the Principles are of a voluntary nature with no enforcement mechanisms ensuring their implementation. Companies should therefore be encouraged to strengthen their own policies and management systems and not to wait for states to implement stronger policies and regulations. Investors have a critical role to play in encouraging companies to do so.

Effective implementation of the Guiding Principles is a learning exercise. There will surely be many human rights dilemmas to be solved, requiring further elaboration and fine tuning of the Principles. Nonetheless, the bottom line is that these Principles, and their acceptance by the UN Human Rights Council and other international agencies, are good news for business and for investors. They should be commended for bringing about greater conceptual clarity and practical guidance, and for highlighting that both states and business must play their own part in achieving a common goal. By raising the bar on all fronts, the Principles will help both companies and investors to mitigate risk and, most importantly, to contribute to the protection and advancement of human rights.

Introduction

John Ruggie's Guiding Principles on Business and Human Rights represent a significant step forward in the way in which many decision-makers in government, business and elsewhere think about business and human rights. They also present an opportunity for companies and investors to enhance their management of human rights risks.

In this paper Sustainalytics outlines Ruggie's Guiding Principles and presents a set of recommendations for institutional investors, based on the Principles, that will help establish or enhance the implementation of responsible investment (RI) policies and strategies, from the integration of environmental, social and governance (ESG) issues to active ownership.

Specifically, this paper will:

- Provide a brief overview of the Principles;
- Detail the risks that companies and their investors face with respect to human rights issues;
- Provide an analysis of how such risks may be impacted by Ruggie's framework;
- Describe how to anticipate these risks and the potential opportunities and benefits the Principles offer to institutional investors;
- Lastly, it will look at the future impact of the Principles.

I. Background on the Work of John Ruggie

Many companies have traditionally argued that human rights are the purview of the state. Various initiatives in the last decade have sought to change this view. In 2003, the United Nations Sub-Commission on the Promotion and Protection of Human Rights adopted the Draft Norms on Business and Human Rights, a treaty-like document outlining the duties that companies have with regard to human rights. The initiative faced strong opposition from the business community, which felt that businesses could not be burdened with what they believed to be an obligation of the state: protecting human rights. State support for the initiative also dwindled. It seemed that the Norms were ahead of their time, attempting to take a quantum leap where small steps might have been more successful.

UN Special Rapporteur John Ruggie was appointed to take such steps. In a report released in 2008, Ruggie outlined his well known “Protect, Respect and Remedy” Framework. Based on three years of extensive consultations, the framework clarified the responsibilities that states and businesses have with regard to human and labour rights and argued for the need for access to remedy. Ruggie later produced the Guiding Principles, which specify what the implementation of the framework means in practice.

In June 2011 the UN Human Rights Council, in an unprecedented move, unanimously adopted the Guiding Principles. It was decided that these Principles should serve as the framework for further policy development and standard-setting on businesses and human rights. A new UN Working Group will be established and will work toward the further implementation of the Principles.

Ruggie’s work has become the main international authority on the topic of business and human rights. In addition to being adopted by the Human Rights Council, the Framework and the Principles have been drawn upon or incorporated into the principles, guidelines and/or regulations of numerous governments, international organizations, business associations, as well as civil society, labour organizations, human rights, and investor organizations. For example:

- In May 2011, the Organization for Economic Cooperation’s Guidelines for Multinational Enterprises were revised to incorporate the Ruggie Principles;²
- A current review of International Finance Corporation (IFC) Performance Standards on Social and Environmental Sustainability aims to strengthen the Standards’ approach to human rights based on the Ruggie Framework;³
- In November 2010, the International Standards Association released its ISO 26000 standard on corporate social responsibility, which contains a human rights section that clearly reflects the Ruggie framework.⁴

2. The Guiding Principles

The Guiding Principles are grouped according to the three pillars of Ruggie’s “Protect, Respect and Remedy” Framework:

- 1) The state’s duty to protect human rights;
- 2) The corporate responsibility to respect human rights; and
- 3) Access to remedy.

2.1 STATES AND HUMAN RIGHTS: THE STATE'S DUTY TO PROTECT

The first section of the framework outlines the duty of states, which are bound to protect human rights in accordance with any treaties or conventions of which they are signatories.⁵ This duty includes the protection of citizens from human rights violations committed by non-state actors, including businesses. In defining the duty of states, this section of the Principles provides institutional investors with general and conceptual clarity on the human rights responsibilities of businesses. It also defines where this responsibility ends, which allows an institutional investor to respond to stakeholder demands related to responsibilities that fall clearly in the domain of the state. However, as Ruggie acknowledges, there is a gap between what can be expected from the state and current prevailing practice. He exposes serious weaknesses in states' human rights protection mechanisms, including their unwillingness or inability to hold companies to account when they become linked to human rights violations. For example, in most nations there is a striking inconsistency between government human rights policies and policies that directly govern business practices. The resulting accountability gap contributes to the possibility of human rights violations. To address this gap, in Ruggie's view, states need to explicitly broaden human rights protection policies and legislation to include violations resulting from business activities. Such changes would have implications for businesses and for investors, as discussed in Section 4 below.

2.2 BUSINESS AND HUMAN RIGHTS: THE CORPORATE RESPONSIBILITY TO RESPECT

The second pillar of the Ruggie Framework defines the relationship between business and human rights. Ruggie uses the term "responsibility," rather than "obligation," when referring to a business' role in protecting human rights, as international human rights law currently does not impose obligations directly on companies. The principles in this section of the Framework will, to the extent that they are taken up by business, bring about a major step forward in how the relationship between business and human rights is generally viewed.

Ruggie provides several strong moral, legal and business-related arguments as to why businesses should be concerned about human rights. He also discusses specific human rights-related risks, and presents two primary means of mitigating these risks: legal compliance and a due diligence approach.

LEGAL COMPLIANCE

When it comes to ethical matters, a company's first reference point is usually the law. The identification of these human rights-related laws, ranging from labour laws to laws dealing with indigenous communities, should be a standard exercise in compliance-related risk management. Yet in many countries, the absence of strong laws, or the lack of enforcement of existing laws, creates a legal grey area with little guidance. Companies should therefore adopt a due diligence approach.

DUE DILIGENCE

A due diligence approach aims to understand and manage human rights exposure and mitigate any potential human rights impacts. Such an approach is proactive at all levels and ensures that the company is aware of and able to respond to any human rights risks associated with its operations. Proper due diligence includes human rights risk assessments, the establishment of mechanisms to address risks, ongoing monitoring, and transparency. As will be discussed further in Section 5 below, Sustainalytics finds this to be the core element of the Ruggie Framework that has the most relevance and provides the greatest benefit to investors.

Due Diligence in the Telecommunications Sector

In recent years, a number of telecommunications and Internet companies have faced major exposure to human rights issues and, in some cases, allegations of complicity in human rights violations. Examples include Yahoo in China, Alcatel-Lucent in Burma and, more recently, Vodafone in Egypt. Often the allegations relate to demands for restrictions on freedom of expression, especially during times of civil unrest or strife.

In February, Vodafone came under fire for abiding by Egyptian demands to shut down mobile services and send out pro-government text messages to its clients with the aim of curbing anti-government demonstrations.⁶ Vodafone clearly chose to support a government that was under fire for its shady track record on human rights and corruption. The company responded by stating that, legally, it had to abide by the government's requests stemming from Egypt's emergency laws. Ruggie's Guiding Principles suggest that this perspective should not be taken for granted. A due diligence approach in such a scenario could have entailed a range of preventive and responsive steps, such as:

- Implementing a human rights policy that referred specifically to the risk of restrictions on freedom of expression.
- Undertaking human rights risk assessments that would have led to a list of countries with a poor track record. This likely would have included Egypt.
- Joining a multi-stakeholder initiative on human rights-related issues, such as the Global Network Initiative (<http://globalnetworkinitiative.org>), which provides guidance on how to respond to such state demands.
- Asking that state authorities provide a written request, including legal arguments, in relation to the above-mentioned text messages or other state demands. This would have allowed the company to similarly obtain legal advice from respected UN bodies.
- Having certain contractual obligations in place dealing with the risk of restrictions on freedom of expression.

Although Vodafone has a brief, general human rights policy statement in place, there is no evidence that it has taken any of the due diligence steps above. Had it done so, the company would have been significantly better positioned to respond to the Egyptian government's request.

2.3 THE RIGHT TO REMEDY

Ruggie's third pillar addresses remedy mechanisms that can be established by a state or by a company. At the company level, remedy mechanisms may address the violation of employee rights, or communities affected by a company's operations. Effective remedy mechanisms play an important role in risk management. By addressing any concerns and grievances at an early stage, remedy mechanisms may prevent lengthy court cases or media exposure. The relative importance for each company of such mechanisms varies depending on the industry, location, and other specific characteristics that influence its human rights exposure. For example, remedy mechanisms are far more important for a global mining company than for an IT company operating in Europe. The relevance of such mechanisms to investors is described in Section 5 below.

3. Human Rights and Business Risk

Human rights create considerable and increasing risks to companies and their shareholders. From a company and investor perspective, a primary reason for attending to human rights issues is to manage exposure to such risks. Before discussing the importance of Ruggie's Guiding Principles to the management of these risks, it is useful to provide an overview, based on Sustainalytics' analysis, of what these risks entail. Key areas of risk include operational and physical risks, regulatory risks and reputational risks.

OPERATIONAL AND PHYSICAL RISKS

Human rights issues can generate numerous operational and physical risks for businesses, including project delays or cancellation caused by the denial or withdrawal of necessary operating permits; the loss of a social licence to operate; problematic relations with local labour markets; higher insurance, financing or security costs; lower production outputs; costs associated with challenging community consultation processes; damage to property; or costly lawsuits initiated by impacted stakeholders and others. All of these risks can have a material impact on financial outcomes for investors.



Human Rights and Operational Risk in the Extractive Industries

There are numerous examples of how human rights issues can generate operational risk:

- In June 2011, in an effort to halt weeks of unrest and violence caused by community opposition, the Peruvian government revoked the license of Canadian mining company Bear Creek Mining to develop a mining project in Southern Peru. The violence had resulted in five deaths and more than 30 injuries. The company will be able to proceed only after obtaining approval from local indigenous people. It has threatened to sue the Peruvian government over the loss of its license.⁷
- Southern Copper Corporation, a U.S.-listed mining company operating in Mexico, has a history of conflicts with trade unions over labour rights and safety-related concerns. Between 2006 and the end of 2010, the company experienced a lengthy closure of its mining operation, lengthy court cases and damage to company property caused by striking workers.⁸
- In 2010 a group of responsible investors engaged with Talisman Energy on the subject of indigenous people and the concept of Free, Prior and Informed Consent (FPIC). In part as a result of this engagement the company commissioned an independent report on the feasibility of a strong policy on indigenous people. The report concluded that being the first company to adopt an FPIC policy would give Talisman a competitive advantage. Talisman's adoption of such a policy was widely applauded by investors.⁹

LEGAL AND REGULATORY RISKS

International human rights treaties may be translated into domestic legislation, where they may have a direct impact on companies. For example national legislation on the protection of labour rights, such as anti-discrimination legislation, or laws upholding freedom of association, is largely based on the work of the International Labour Organization (ILO). Some states may also require that a company obtain the consent of indigenous people before proceeding with a project that will affect them. The violation of such laws may lead to costly fines or lawsuits that could negatively affect a company's bottom line, especially if these incidents are recurrent. The stakes are raised when there is clear evidence of a company's direct complicity in human rights violations. In October 2009 the UK High Court froze £5 million of the assets of Monterrico, a subsidiary of Zijing Mining, setting aside what Monterrico may have to pay in legal costs and damages if it loses a lawsuit related to human rights violations at its mining operation in Peru.¹⁰

As described in Section 4 below, the potential increase in regulatory risks and compliance costs faced by investors depends on the extent to which states take up Ruggie's call to make legislative changes in line with the Guiding Principles.

REPUTATIONAL RISKS

Reputational risks may accompany all of the risks described above. Allegations of complicity in human rights violations often result in negative publicity, campaigns by NGOs and other initiatives that may damage a company's brand. In recent years some NGOs and even some media sources have shifted their focus from companies facing allegations of complicity to major investors in such companies. Institutional investors in numerous countries have been exposed to strong media criticism, shareholder action and, in some cases, even street protests over their financing of companies involved in controversial operations such as the construction of settlements in the Palestinian territories or the sourcing of minerals from conflict zones in Africa. Negative reactions may result merely from perceived or alleged human rights violations, regardless of whether or not the allegations are well grounded. As Ruggie's work gains broader acceptance and momentum, it is likely that NGOs will leverage the Principles to put more pressure on companies, appealing to them as an authoritative framework and benchmark.

4. The Impact of Ruggie: Additional Risks for Investors?

Ruggie recommends that states adopt new policies and regulations governing human rights, including laws that allow them to hold companies accountable in cases of negative human rights impacts. What might this mean for companies and investors?

A number of states have already passed legislation or regulations consistent with Ruggie's recommendations, including the integration of human rights considerations into export credit agency policies, procurement policies or bilateral investment treaties. Export Development Canada, for example, has made strong statements in support of Ruggie's work and reports that it aims to integrate the Principles into its policies.¹¹ Elsewhere, such as in the UK, governments are assessing the areas in which new legislative changes are needed.¹²



Sustainalytics has identified the following areas in which possible regulatory changes will have the greatest effect on companies and investors:

- **Criminal accountability:** This area relates to the risk of complicity in human rights violations committed by other actors. If a company is alleged to have contributed to, exacerbated or facilitated some of the most serious human rights violations, such as torture, war crimes, or crimes against humanity, it (or its employees) may be liable under national criminal laws. Such instances are more likely to occur in high-risk countries already known for their serious human rights violations, such as Sudan, Burma, Iran or countries experiencing internal conflicts.

This risk may increase due to Ruggie's call for the adoption of extra-territorial jurisdiction, which enables a state to exercise jurisdiction over human rights abuses, including business-related abuses that occur outside its own territory. Such laws broaden the scope and possibility of corporate liability. For example, Chiquita Brands is now embroiled in a lengthy court case for allegedly violating U.S.-based extra-territorial laws by contributing to human rights violations in Colombia.¹³ This legislative development may result in more high-profile lawsuits against companies, some of which may lead to costly and lengthy trials or possibly even the imprisonment of company staff. Although these lawsuits are most likely to be directed at the companies directly operating in human rights sensitive regions, they may eventually turn their focus to institutional investors as well.

- **New national laws:** Ruggie recommends that states broaden their human rights protection by adopting new policies, laws or regulations to protect people against abuses from non-state actors including businesses. In doing so they should adopt stricter laws on issues such as child labour, indigenous peoples' rights or other human rights issues. Companies need to be aware of these laws in order to avoid fines, legal repercussions or the withdrawal of operating permits. In June 2010, an amendment to the U.S. Dodd-Frank Consumer Protection Act requires companies that utilize "conflict minerals" to conduct due diligence and provide evidence that their products are not contributing to conflict in the Democratic Republic of the Congo. Companies must disclose their due diligence efforts in sourcing these minerals to the Securities and Exchange Commission on an annual basis and may risk breaching the law if they cannot provide sufficient evidence. Yet another amendment to the act requires companies in the extractive industries to report their payments to foreign governments, a practice that is important to human rights protection in the case of countries with poor human rights records. The aim of this amendment is to identify, and ultimately minimize, the human rights and corruption related impacts of certain business activities in controversial countries.

States may also adopt specific legislation aimed at preventing certain controversial products from entering their markets. The EU is currently debating new legislation that would forbid member states from importing goods produced by child labour. This legislation may particularly (although indirectly) impact investors who continue to invest in companies found to be in breach of this legislation or whose market access is blocked. In recent years a number of countries have adopted legislation directly aimed at investors. For instance, Belgium, New Zealand, Luxembourg and Ireland have all adopted laws that prohibit institutional investors from investing in cluster munitions. States may adopt similar legislation in other human rights-related areas although this process is likely to be limited to certain key issues and will require considerable national debate first.

- **The establishment of remedy and complaint mechanisms:** By law, state-level grievance mechanisms may be established for individuals or communities whose human rights have been impacted by business activities. Through such mechanisms the victims of human rights violations are able to file a complaint against a company. An example may be complaint mechanisms within national human rights institutions or an ombudsman. This is still relatively new territory and although it may lead to complaints directed at financial institutions, it is not expected that institutional investors will experience significant impacts once these mechanisms are adopted.

Beyond legal implications, as mentioned above, the Ruggie Principles have already found their way into non-binding guidelines and standards such as the OECD Guidelines for Multinational Enterprises, the IFC's Performance Standards and ISO 26000. Each of these initiatives may affect institutional investors, although probably to a limited degree. For example new human rights requirements in the OECD Guidelines for Multinational Enterprises provide new avenues for complaints. In the past, financial institutions have been exposed to OECD complaints and, although of a non-binding nature, these complaints can create reputational risks to investors.¹⁴

To conclude, the Ruggie Guiding Principles strongly call for new national policies and regulations some of which, once adopted, will lead to increasing (criminal) accountability of companies. These developments will be rather ad-hoc, strongly dependent on political will, and are likely to occur over a longer period of time. Nonetheless, such new regulations are likely to entail new human rights obligations for companies. For companies that do not manage human rights issues adequately, this may result in additional lawsuits, fines or other human rights-related risks. The institutional investors that manage human rights issues well will be best positioned to adapt to any legal changes resulting from Ruggie's work.



The institutional investors that manage human rights issues well will be best positioned to adapt to any legal changes resulting from Ruggie's work.



5. Opportunities: A Framework for Anticipating & Managing Risks

Due to the likelihood of new government regulations, Ruggie’s work can be viewed, as described above, as a new source of regulatory risk for companies and, more indirectly, for investors. However, in Sustainalytics’ view, by clarifying the respective responsibility of states and corporations, and by providing practical guidance aimed at understanding and mitigating human rights-related risk, the Principles, when implemented, will have the effect of reducing risk. Thus they offer an opportunity to all companies, and their investors, to manage risk more effectively.

In Sustainalytics’ view, the Guiding Principles offer three major benefits to investors:

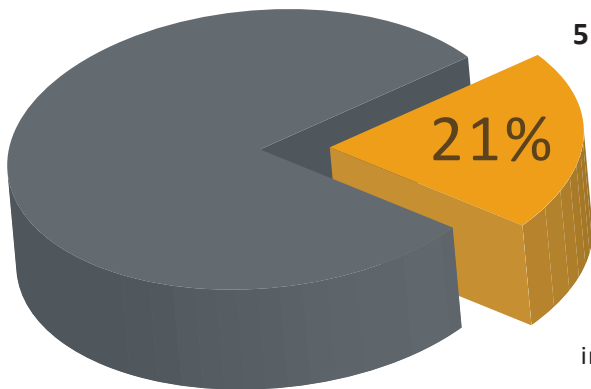
- They provide a robust, authoritative framework upon which to build RI investment policies and due diligence management systems that address human rights;
- They provide a framework for assessing the human rights policies, management systems and performance of individual companies in an investment universe;
- They provide practical guidance for active ownership, through engagement and proxy voting, on human rights issues.

The manner in which responsible investors can put the Guiding Principles into practice is outlined below.

5.1 ANTICIPATING AND MANAGING HUMAN RIGHTS RISKS

The primary benefit of Ruggie’s Guiding Principles to both companies and institutional investors, in Sustainalytics’ opinion, is its recommendations regarding human rights policies and due diligence management systems. The Principles are applicable to all types of companies and investors. However, as Figures 1 and 2 illustrate, companies in certain industries could do more to adopt the Principles and implement human right policies. Below is Sustainalytics’ view of how the Principles can be implemented by institutional investors.

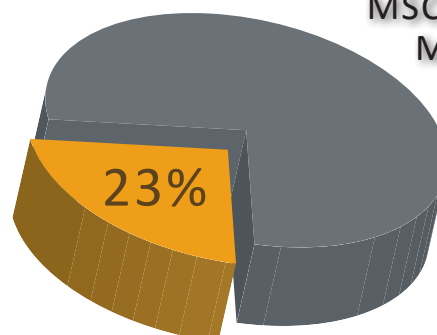
MSCI Developed Market Oil Companies



- Human Rights Policy
- No or Limited Human Rights Policy

Figure 1

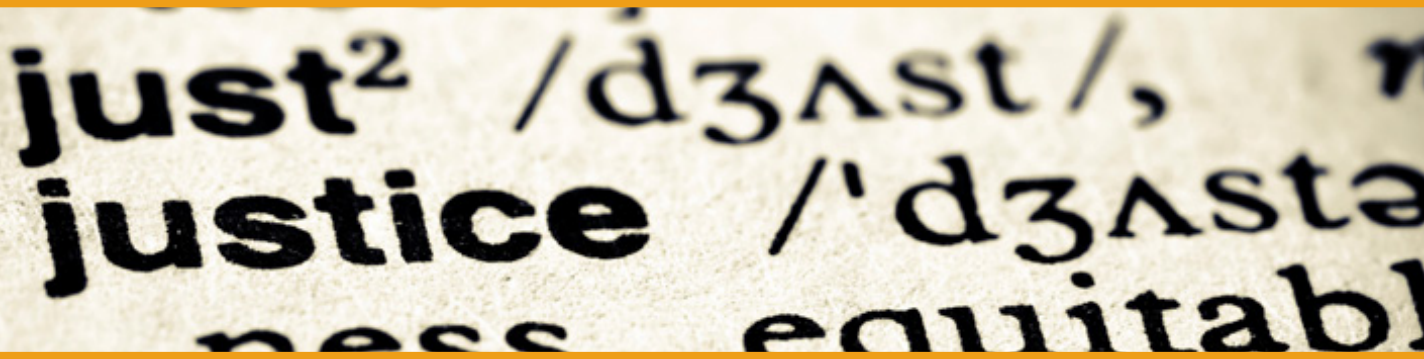
MSCI Developed Market Mining Companies



- Human Rights Policy
- No or Limited Human Rights Policy

Figure 2





just² /dʒʌst/,
justice /'dʒʌstə
ness equitable

ADOPT A POLICY ON HUMAN RIGHTS (PRINCIPLE 16)

The starting point for the management of human rights issues is the creation of a policy. The Guiding Principles provide general recommendations that may form the basis of either a brief policy statement or a detailed policy that can be used to integrate human rights considerations into elements of an RI strategy ranging from ESG integration to active ownership. Sustainalytics considers the following policy elements, which are in line with Guiding Principles, to be important to a best practice human rights policy for institutional investors and financial institutions:

- Reference to international human rights standards such as the nine core human rights treaties as well as relevant labour standards.^{15, 16}
- The integration of human rights considerations into all financial activities ranging from investments, loans and fixed income to project finance activities.
- References to stakeholders, including an institutional investor's own employees, customers, affected communities, and others.
- Reference to specific human rights themes that are frequently known to have an impact on companies and investors, such as the rights of indigenous peoples, labour rights or the right to freedom of expression.
- A commitment to establish formal mechanisms for dialogue with all relevant stakeholders, including civil society and governmental bodies, on human rights matters.
- Commitment to a full due diligence process including risk assessments, transparency, the adoption of implementation programs and mechanisms, and monitoring and reporting (as outlined below).

Human Rights Policies at Financial Institutions

A growing number of financial institutions are creating policies that explicitly address human rights concerns.

Examples include:

- Barclays Group has adopted an extensive policy statement on human rights that includes references to the Ruggie Framework. Barclays' policy affirms the need to ensure that human rights impact assessments are taking place for all of its activities. It also commits to a structural dialogue regarding human rights with concerned stakeholders. Of particular interest is the fact that the Bank acknowledges the different human rights impacts that may accompany various financial services ranging from project finance to providing loans to states, and it highlights the need for identifying these risks. The Bank also explicitly applies its human rights requirements to its subsidiaries.
- ASN Bank adopted a detailed human rights policy that explicitly addresses specific human rights themes, including labour rights and security issues. In its policy ASN has defined a separate category for what it calls the most serious human rights violations, which include genocide, torture, crimes against humanity and war crimes. This distinction, which is based on international law, allows the bank to separate more common and lower-risk human rights controversies from major ones. With regard to legal compliance, particularly noteworthy is ASN's statement that "if there is conflict between standards (national vs. international), the bank applies the standard that gives the most protection to the individual." This implies that ASN Bank is not merely using domestic law as its reference point for assessing human rights matters, especially when these laws fail to offer sufficient human rights protection.

IMPLEMENTING DUE DILIGENCE

The principle of due diligence is at the heart of Ruggie's recommended approach to managing exposure to human rights issues, and it underlies a number of the specific Guiding Principles for corporations. The following due diligence principles are of particular importance to institutional investors:

ENSURE HUMAN RIGHTS RISK IDENTIFICATION AND ASSESSMENT (PRINCIPLES 17, 18)

The human rights exposure of financial institutions and institutional investors is largely through lending and investment activities. The nature and degree of the exposure varies significantly depending on the nature of the financing activity. For example, project finance activities may generate human rights risks related to the impacts of a project on local communities, while investors with involvement in the extractive industries in countries such as the Democratic Republic of the Congo or Burma may face allegations of complicity in human rights abuses that may end up being debated at their AGMs. Companies from the IT sector that have not been associated with human rights violations may suddenly face new risk when operating in countries known for severe restrictions on freedom of expression, such as China, Iran or North Korea.

Responsible investors should have a clear process to identify, assess and monitor all human rights-related risks for all of their lending and investment activities. To realize this investors should ensure that there is a human rights mandate and expertise within internal risk management bodies. One method of risk assessment entails regular and systematic portfolio analysis using human rights criteria that aim to identify the most high-risk companies.

Identifying and Assessing Human Rights-related Risk

PGGM Vermogensbeheer, an investment manager in the Netherlands, has established a high-level ESG expert group that includes human right experts from inside and outside the company and that functions as an independent advisory group on human rights-related dilemmas. They identify potential risks related to certain human rights themes, or companies that are under scrutiny. They also advise PGGM on sensitive decisions related to companies under assessment for human rights issues.

ENSURE THAT MECHANISMS ARE IN PLACE TO INTEGRATE AND RESPOND TO HUMAN RIGHTS IMPACTS (GUIDING PRINCIPLE 19)

Investors need to ensure that information on human rights impacts is integrated into relevant internal functions and processes in order to ensure appropriate action in the management and mitigation of any human rights issues that have been identified. In other words, they need to ensure that their human rights policy commitments are embedded in the processes of all relevant business functions. For responsible investors, this implies the application of different responsible investment instruments ranging from investment decision-making to engagement and/or exclusion. Ensuring appropriate action generally requires support from, and the oversight of, high-level management and the board. The strategies for addressing these human right concerns should also be included in policy budgets. Another ingredient in the management and mitigation of human rights issues may be to establish a formal dialogue program with concerned stakeholders such as NGOs and community representatives to discuss specific human rights impacts.

MONITORING AND TRACKING (GUIDING PRINCIPLE 20)

Monitoring and tracking is used to ensure that human rights policies and programs are effective. They are also used to measure progress that institutional investors can report to the public. Monitoring should be structured and conducted by assigned company staff or by an independent third-party auditor. Although it is not easy to study the effects of a human rights policy, stakeholder dialogue is an effective way to gather anecdotal evidence. One means of monitoring the effects of a human rights policy is to conduct regular portfolio assessments to determine the number and nature of controversial companies within the investment portfolio over time. This allows the investor to see if its overall RI policies, ranging from ESG integration to engagement activities, have proven to be effective in mitigating risk.

REPORTING (GUIDING PRINCIPLE 21)

Currently, human rights issues are underrepresented in corporate social responsibility (CSR) reports compared to environmental or governance issues. Nonetheless, companies, including many financial institutions and institutional investors, have significantly increased their public disclosure on human rights issues along with other ESG-related matters over time. Annual and CSR reports may include a description of both the human rights risks as well as the relevant steps the company has taken to address them. As a best practice, investors could also report on challenges that arise during the implementation of their human rights policies. Such disclosure may create some vulnerability, but it demonstrates sincerity and honesty in a company's due diligence approach. Investors may also consider publishing ESG-related allegations from concerned stakeholders, such as NGOs, on their own websites, accompanied by a company response to the allegations.

Reporting on Human Rights Policy Implementation

The Government Pension Fund of Norway discloses information on all of the companies that are excluded from the fund's portfolio based on human rights criteria. It provides a detailed public document that outlines the concerns that the Fund has with specific companies, along with engagement results, and links these to the Fund's exclusionary criteria. This disclosure enables concerned stakeholders to understand, and respond to, the decisions of the pension fund. This best practice is accompanied by a certain level of vulnerability: new questions from stakeholders, such as questions regarding similar companies that have not been excluded, may arise.

ACCESS TO REMEDY

The third pillar of Ruggie's framework is ensuring access to grievance mechanisms that will allow victims of human rights violations to make complaints and seek remedies. This section of Ruggie's Guiding Principles is of most relevance to states and to companies directly associated with human rights violations. Ruggie asserts that companies, or coalitions of companies, can work together within a sensitive human rights context and should strive to adopt grievance mechanisms. Such mechanisms can provide a channel through which affected stakeholders can voice concerns at an early stage and help to mitigate risk for companies. These Guiding Principles are of less relevance to investors. Although a financial institution may certainly ensure that its internal complaint and/or whistleblower mechanisms are a channel to address certain types of human rights concerns, institutional investors are not likely to be confronted with the responsibility to provide remedies to the victims of human rights violations. The Guiding Principles in this section are, however, of use to investors from an engagement perspective, as discussed below.

5.2 RUGGIE-BASED PORTFOLIO ASSESSMENT: INCORPORATING HUMAN RIGHTS INTO INVESTMENT DECISION MAKING

Responsible investors should strive to be fully aware of any human rights risks faced by companies in their portfolios in order to make sound investment decisions based on ESG considerations. To date, human rights assessments of investment portfolios focus primarily on human rights controversies, and frequently these relate to companies operating in high-risk sectors and/or countries. Investors may subsequently struggle with whether to exclude or engage with companies deemed to be high-risk based on the sector or country in which the company operates. Responsible investors should consider the company's management of its human rights risks, which can be an indicator of the likelihood of risks escalating or being resolved. Assessing how companies are integrating the Ruggie due diligence framework is an additional filter that enables investors to understand the extent to which a company can be trusted to manage its human rights risks.

In sum, investors may consider carrying out human rights assessments that combine the risks stemming from certain countries or sectors with the extent to which a company implements a due diligence approach, and base their investment decision on this outcome. Such an assessment may also be used to define the best-in-class companies with regard to human rights performance, including in relation to specific issues such as indigenous people's rights.

5.3 ACTIVE OWNERSHIP: ENGAGEMENT ON HUMAN RIGHTS

While Ruggie's work does not answer every question about how to address specific human rights issues, the Principles, especially those related to a due diligence approach, can be translated into a concrete agenda and set of goals for engagement with companies. Although engagement goals may be fine-tuned to specific companies and company operations, Sustainalytics summarizes the general goals as follows:

- Companies should adopt a best practice policy on human rights based on the Ruggie Framework and address additional specific human rights issues relevant to their operations. (See also 5.1 for detailed policy recommendations.)
- Companies should ensure that they adopt a due diligence approach that includes:
 - Human rights risk identification and assessment;
 - Mechanisms to ensure that human rights information is effectively integrated into business functions in order to ensure that appropriate action is taken to manage and/or mitigate risk;
 - Systems to track and monitor human rights performance; and
 - Public disclosure of policies, management systems, and performance outcomes.
- Companies should establish remedy mechanisms in line with the recommendations provided by Ruggie.

These Principles can be either implemented at the company level or in relation to specific controversial operations. Each recommendation offers opportunities for more detailed discussions and exchange of best practices. Investors should demand specific examples of the implementation for each of the above elements. Importantly, by framing their engagement agenda in terms of the Guiding Principles, investors will be able to appeal to an authoritative international standard, increasing the chances of successful outcomes.

Can a company manage all of its human rights risks all of the time? This is a key question that investors will face and to which the Ruggie does not provide a reply. Take, for example, a company operating in a country associated with the worst type of human rights violations and that is obliged to closely collaborate with these authorities. In such a scenario the company may well implement due diligence, undertake risk assessments and adopt programs to counters any risk. Yet, in the end it may simply not be able to avoid getting entangled in these violations. Simply said, there may be instances in which the human rights risks are so pervasive that it is extremely difficult, if not impossible, to mitigate them adequately. Investors will then have to make an investment decision based on these ongoing risks. However, only by means of implementing the Guiding Principles will we understand its effects and any possible limits still to be addressed.

ENGAGEMENT WITH STATES

Another important engagement goal, addressed only briefly in Ruggie's report but worthy of elaboration from an RI perspective, concerns engagement with state bodies. While businesses engage with states on a broad range of issues, including economic and environmental matters, they rarely engage on the topic of human rights. This reluctance may result from an unfounded fear of "becoming political," although it appears to be subsiding as more businesses are directly discussing human rights-related matters with local and national government bodies. Examples of such business-state discussion include Total SA's past pleas for the release of Aung San Suu Kyi in Burma, and Yahoo's request to the U.S. government to help in the release of a Chinese human rights activist who had been arrested as a result of information that the company had supplied to Chinese authorities.

Investors are similarly developing initiatives related to engaging with states. In November 2009 Dutch pension fund APG Pension Group Asset Management published an article in a Dutch newspaper entitled *To be a shareholder and diplomat*, which called upon investors to engage more actively with state authorities. APG stated that "the dialogue on human rights is no longer state-business only."¹⁷

Engaging with states on matters such as human rights is new territory for most investors and it raises questions about how to approach such engagement. The Ruggie report does not address this area in detail. Nevertheless the entire first pillar of the Ruggie Framework, which addresses the state's duty to protect, provides a solid agenda, concepts and language for conversations with government.

Engagement with states may be smartly linked to high priority RI themes as well as to some of the specific financial services provided. Examples might include:

- An investor, or a coalition of investors, with large stakes in retail companies operating in a country known for child labour issues could encourage local regulatory bodies to ensure that relevant ILO labour standards are implemented. It could request oversight by state institutions or strive to establish a public-private partnership to address the issue.
- Investors, intending to invest in a new mining project, could request that the local government ensure that an independent human rights impact assessment is undertaken.
- Investors, with stakes in a company involved in trade union conflicts, could ask the central government for the release of activists arrested because of their trade union activities.
- Investors, financing an energy project in a conflict zone, may call for independent investigations into allegations of police violence; or they may raise concerns about a lack of human rights standards for security troops.

6. Looking Forward: Ruggie in the Years to Come

To conclude:

- States should bridge the accountability gap that Ruggie has exposed. The Guiding Principles, although currently of a non-binding nature, foresee changes in how companies will be held accountable for their human rights impacts. New laws and policies will impact investors by means of their effects on companies within their investment portfolio. However some new laws or policies may be directly aimed at institutional investors.
- While such laws may generate some new regulatory risk, the Guiding Principles' overall effect will be to reduce risk for investors, as they will encourage companies towards more responsible human rights policies and performance.
- Companies should not wait for states to act. From a risk management perspective, and to anticipate future legislation, companies should adopt their own due diligence policies. For institutional investors this means using the Guiding Principles throughout their RI policies and activities, including due diligence-based investment decision making and active ownership.
- A number of the Principles can be translated into practical recommendations for investors, including guidance on how to implement a due diligence approach that avoids human rights risks associated with various lending and investment activities.

What are the next steps now that Ruggie's specific mandate has ended? A new UN-working group will further the implementation of the Principles, although at this stage the end result is unclear. It is fair to say that the implementation of the Guiding Principles will be strongly dependent on the political will of both state and non-state actors alike to take further steps. An increasing number of companies and states will however adopt new policies and practices based on the Guiding Principles. NGOs, some of them concerned about the voluntary nature and still general character of the Guiding Principles, will increasingly push for the adoption of legislation at the state-level which allow them to hold companies to account. Similarly they will use the Ruggie framework as a reference tool in their assessment of companies.

It should indeed be noted that Ruggie's Framework is still of a general nature and does not provide detail on specific human rights issues or countries. Therefore the extent to which its application at the operational level will be effective is still to be determined, and this surely will be a learning process. However, new guidelines, toolkits and other programs are being developed around the world that will provide more guidance on specific regions, business sectors and human rights themes.¹⁸ Through the ongoing development and sharing of best practices, companies and investors have an opportunity to put Ruggie's Guiding Principles into practice and to raise the bar on the protection and advancement of human rights.

About the Author

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Daan is the product manager of Sustainalytics' UN Global Compact Compliance Service which involves managing the research of companies' adherence to a leading international corporate social responsibility standard. He also coordinates several engagement activities, including in-depth company dialogues. Daan specializes in human rights, labour rights, arms trade, legal issues and UN standard setting related to corporate social responsibility. Prior to joining Sustainalytics Daan worked at the Dutch Ministry of Foreign Affairs as a senior policy officer on human rights. He also worked as an advocacy coordinator at Amnesty International for six years and with a non-governmental organization on issues related to peacebuilding. Daan is currently the vice-president of the Dutch branch of the International Commission of Jurists. He graduated with a degree in Anthropology specializing in environmental issues and completed a Master's degree in Development Studies. He also holds several degrees in International Law. Daan speaks fluent Dutch and English, and intermediate Spanish and French.

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About Sustainalytics

Sustainalytics is a leading global provider of environmental, social and governance (ESG) research and analysis for investors and financial institutions. We provide a global perspective, underpinned by nearly 20 years of local experience and expertise in the responsible investment market. Sustainalytics strives to continuously provide high-quality solutions and commits to remain responsive to the current and future needs of our clients. Recently, Sustainalytics was voted Best ESG Research House by IPE/TBLI. Sustainalytics is headquartered in Amsterdam and has offices in Boston, Frankfurt, Madrid, Paris, Timisoara and Toronto; and representatives in Brussels and Copenhagen.

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Endnotes

- ¹ For the full text of the Principles see <http://www.business-humanrights.org/media/documents/ruggie/ruggie-guiding-principles-21-mar-2011.pdf>.
- ² OECD website: http://www.oecd.org/document/36/0,3746,en_2649_34889_46078244_1_1_1_1,00.html.
- ³ IFC website: [http://www.ifc.org/ifcext/policyreview.nsf/AttachmentsByTitle/PhaseI_Progress_Report1-11-10.pdf/\\$FILE/PhaseI_Progress_Report1-11-10.pdf](http://www.ifc.org/ifcext/policyreview.nsf/AttachmentsByTitle/PhaseI_Progress_Report1-11-10.pdf/$FILE/PhaseI_Progress_Report1-11-10.pdf).
- ⁴ Institute for Business and Human Rights: http://www.ihrb.org/commentary/guest/iso_26000_a_new_standard_for_human_rights.html.
- ⁵ States may also have human rights obligations irrespective of the treaties they have ratified. Some human rights obligations result from customary law, a set of principles derived from generally accepted custom.
- ⁶ Juliette Garside. "Vodafone under fire for bowing to Egyptian pressure." [guardian.co.uk http://www.guardian.co.uk/business/2011/jul/26/vodafone-access-egypt-shutdown](http://www.guardian.co.uk/business/2011/jul/26/vodafone-access-egypt-shutdown) (accessed July 26, 2011).
- ⁷ Terry Wade. "Bear Creek files suit in Peru over mine," [news.yahoo.com http://news.yahoo.com/bear-creek-files-suit-peru-over-mine-021155455.html](http://news.yahoo.com/bear-creek-files-suit-peru-over-mine-021155455.html) (accessed July 13, 2011).
- ⁸ See: http://findarticles.com/p/articles/mi_hb5976/is_200803/ai_n32281821/.
- ⁹ Talisman: <http://www.talisman-energy.com/upload/editor/File/10417493%20-%20GLOBAL%20COMMUNITY%20RELATIONS%20POLICY%20-%20DECEMBER%209%202010%20-%201%20-%20TLMPRD.pdf>.
- ¹⁰ See <http://www.oxfamamerica.org/articles/british-high-court-freezes-mine-company-assets>.
- ¹¹ Export Development Canada (EDC) is Canada's export credit agency. It offers financing, insurance and risk management services with the aim of helping Canadian exporters and investors expand their international business. See http://www.edc.ca/publications/2010/csr/english/PDF/csr_report_e.pdf.
- ¹² An overview of initiatives is available at <http://www.business-humanrights.org/media/documents/applications-of-framework-jun-2011.pdf>.
- ¹³ Kevin Gray. "Chiquita fails to stop Colombian lawsuit," [Reuters.com http://www.reuters.com/article/2011/06/03/chiquita-colombia-lawsuit-idUKN0315364920110603](http://www.reuters.com/article/2011/06/03/chiquita-colombia-lawsuit-idUKN0315364920110603) (accessed June 3, 2011).
- ¹⁴ For example Dexia and KBC were exposed to OECD complaints for providing project finance to a controversial BTC Pipeline in Azerbaijan, Turkey and Georgia.
- ¹⁵ For a complete overview see: <http://www2.ohchr.org/english/law/index.htm>.
- ¹⁶ For a complete overview see: <http://www.ilo.org/ilolex/english/subjectE.htm>.
- ¹⁷ www.citysite.nl/link/1/nieuws/2400973/419Beleggen+en+mensenrechten+Wees+tegelijk+diplomaat+en+aandeelhouder.html.
- ¹⁸ Examples of detailed human rights-related recommendations can be found in the UN's Guidance on Responsible Business in Conflict-Affected and High-Risk Areas (http://www.unglobalcompact.org/docs/issues_doc/Peace_and_Business/Guidance_RB.pdf) and a publication by the UN Global Compact Network entitled How to do Business with Respect for Human Rights (http://www.unglobalcompact.org/docs/issues_doc/human_rights/Resources/how_to_business_with_respect_for_human_rights_gcn_netherlands_june2010.pdf).