



**ICGN**

International Corporate Governance Network

## **ICGN Viewpoint**

### **Human rights through a corporate governance lens**

**April 2015**

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Human rights<sup>1</sup> are attracting increasing attention from a corporate governance perspective as a dimension of both business ethics and enterprise risk management for companies. Indeed, the ethical and risk dimensions are in many ways intertwined, insofar as ethical lapses or inattention to human rights practices by companies may not only breach the human rights of those affected by corporate behaviour, but may also have material commercial consequences for the company itself. In extreme cases human rights problems can pose a franchise risk to companies<sup>2</sup>; in lesser cases these can increase costs and damage valuable relationships with stakeholders.

In a broad governance context human rights cannot be simply framed as a reputational or “non-financial” risk; the consequences of poor human rights practices can materially impact a company’s stakeholder relations, financial performance and prospects for sustainable value creation. Accordingly, human rights are an issue warranting greater attention from long-term investors as a matter of investment analysis, valuation and engagement with companies.

In light of this growing visibility, this Viewpoint report addresses the issue of human rights and their implications for companies and investors, particularly through a corporate governance lens. It raises several questions relating to how companies and boards should provide appropriate oversight and management of human rights practices and also how investors can better understand – and engage companies on— material human rights risks and concerns.

### **What types of human rights abuses can companies be linked to and how is this a matter of corporate governance?**

What constitutes human rights is clearly defined in several international conventions<sup>3</sup> to include traditional issues such as child labor, forced labor, human trafficking/modern day slavery, freedom of association, and indigenous people’s rights. More recently the scope has expanded to include access to proper nutrition,

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<sup>1</sup> While this Viewpoint report focuses on human rights as a standalone issue, it warrants noting that human rights also stand alongside a number of other important issues linked to both business ethics and risk that can have a material impact on both companies and investors; other such issues might include anticorruption, fraud, along with conduct and culture more generally. Identification and prioritisation of human rights issues relative to other ethics-related questions is best addressed at the individual company level, depending on the company’s sectors, geographical jurisdictions and business mix.

<sup>2</sup> Nike is a well-known case study of how child labour in its supply chain came to threaten its global brand. The 2013 Rana Plaza factory collapse in Bangladesh killing 1,100 workers posed significant reputational risks for hundreds of global brands and retailers.

<sup>3</sup> These include: Universal Declaration of Human Rights (UDHR), ILO Conventions, International Covenant on Civil and Political Rights (ICCPR) and International Covenant on Economic, Social, and Cultural Rights (ICESCR).

water and sanitation services, and health services. Emerging issues such as freedom of expression and privacy on the internet<sup>4</sup>, the rights of internet users<sup>5</sup> and sustainable or fair wages<sup>6</sup> broaden concerns into a range of new sectors and all hit at the heart of a company's ability to conduct its business.

As a result, human rights issues have relevance beyond governments, legal systems and civil society: they are also fundamental to good corporate governance. Human rights are at once a growing business risk for companies, and they also present important questions of business ethics that both companies and investors must consider as a fundamental component of good management and long-term stewardship. The ethical dimension emerges in the context of a company's own culture and values, particularly with regard to the impact of human rights practices on key stakeholders, including employees, customers and communities in which companies operate.

### **What should investors expect of companies and boards in terms of ensuring appropriate human rights management?**

Investors should expect both company directors and executive management to show diligence in understanding how human rights risks may exist at the company or in its supply chain. The board is accountable for establishing the appropriate culture and procedures to ensure robust management of these risks. Directors need to build sensitivity to these risks in their oversight of company management and ensure that they are sufficiently informed of how human rights issues may represent material business and reputational risks or might compromise a company's own values and standards of behavior. In turn, investors should hold directors to account for ensuring appropriate oversight.

The United Nations' Guiding Principles on Business and Human Rights (see Appendix A) have been established in recent years to establish a principles-based framework for corporations to address human rights. These UN principles have become a recognised framework, and stress the role of corporates to respect human rights and to act with due diligence with regard to ensuring responsible management of human rights. The ICGN is supportive of this framework, and encourages investors to consider these principles in assessing human rights risks in portfolio companies.

### **What should be expected of investors in companies where human rights concerns may exist?**

The heightened visibility of human rights has also brought attention to the role of institutional investors when investing in companies with real or perceived human rights abuses-- even in cases when institutions are minority shareholders with only a small absolute ownership stake. Investors should be alert to rising expectations by civil society, which can be stimulated by increasing coverage of human rights concerns in both social and traditional media. This can trigger sometimes unanticipated visibility of potential human rights issues at companies that previously may have been below the radar of both boards and investors.

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<sup>4</sup> Addressed by the Global Network Initiative. <https://www.globalnetworkinitiative.org/>

<sup>5</sup> As defined by the EU Commission "Right to be Forgotten" ruling. [http://ec.europa.eu/justice/data-protection/files/factsheets/factsheet\\_data\\_protection\\_en.pdf](http://ec.europa.eu/justice/data-protection/files/factsheets/factsheet_data_protection_en.pdf)

<sup>6</sup> As framed by the Fair Wage Network. <http://www.fair-wage.com/>

A recent case of human rights concerns at the South Korean steel company POSCO resulted in two prominent European investment funds facing OECD criticism on the basis that they may have applied insufficient human rights due diligence in monitoring or engaging on human rights at POSCO—even though both were only minority shareholders with relatively small stakes in the company.

These criticisms came through the OECD’s National Contact Point (NCP) network in individual jurisdictions. The NCP in one European jurisdiction opined that “the OECD Guidelines also apply to minority shareholding of financial institutions.” An NCP in another European country drew the similar conclusion that “the Guidelines apply to fund managers and minority shareholders. Other commentators support the premise that the OECD Principles apply to financial sector actors, including institutional investors, by stating: “the Guidelines are applicable by enterprises in the financial sector. This includes the entire range of financial institutions and actors, e.g. commercial banks, retail banks, investment banks, rating agencies, financial service providers, institutional investors, etc.”<sup>7</sup>

This has broad implications for institutional investors including ICGN members and brings human rights risks and human rights due diligence quite clearly into the corporate governance realm. Even though many minority investors may legitimately question their ability to practically influence company behavior relating to human rights abuses, they nonetheless face the prospect of reputational risk if they are judged to be insufficiently aware of, or engaged with, investee companies on these issues.

A group of European pension funds met with the National Contact Point network in a meeting at the OECD in Paris in December 2014 to have a dialogue on these matters. The discussion centred on how pension funds invest across asset classes, the various approaches to responsible investment within asset classes, including being a shareholder in a public company, and what engagement minority shareholders can undertake on the issue of human rights, both with companies and with their external managers. ICGN may consider engaging further with the OECD and National Contact Points to foster a deeper mutual understanding of the role of investors in this space.

### **What options are available to investors with regard to providing oversight on human rights issues?**

As the case builds for human rights risks being integral to business risks and business ethics, investors will face increasing scrutiny in terms of their own response to human rights practices in investee companies. While it may not be practically possible for investors, particularly those with large numbers of individual holdings, to monitor in detail human rights issues in all portfolio holdings, they may wish to explore different options to assist them in detecting cases in which company human rights practices may warrant greater examination—and ultimately greater engagement.

Specific tactics might include:

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<sup>7</sup>Margaret Wachenfeld, “Recent decisions clarify investor responsibility to address human rights concerns: How the OECD Guidelines for Multinational Enterprises related to investors”, *Responsible Investor*, October 10, 2013 <http://www.ihrb.org/news/op-eds/investor-responsibility-to-address-human-rights-concerns.html>

1. **Proportionate due diligence: one size does not fit all:** Even if comprehensive due diligence on all investment holdings may not be practical, investors should develop an appropriate and proportionate approach to an organization's capacity. Such an approach might focus on key holdings, as well as high risk sectors (mining, oil & gas, apparel, electronics, weapons) or regions (including conflict zones, occupied territories, or countries such as Sudan and Burma), where use of security forces, or disregard of indigenous peoples' rights have the highest risk of linkage to potential human rights abuses.
2. **Develop an appropriate strategy:** A range of options exists for investors, depending on the investor's own investment policies and practices. In the extreme, this might include screening out from investment portfolios those companies that are linked to the most egregious forms of human rights risks-- both from a perspective of responsible investment practices and undue business risks. Less radical tactics might include developing engagement initiatives in material cases, or adopting proxy voting guidelines to support shareholder proposals asking for companies to address human rights due diligence or issue a report on a specific aspect of human rights risk.
3. **Public disclosure:** Investors should consider disclosure of their governance policies to provide both companies and other stakeholders with an understanding of their approach to assessing human rights risks and managing them. This can link into the broader integration strategy of how other relevant environmental, social and ethical risk factors fit into the investment process. In some cases voting outcomes may be influenced by consideration of a company's human rights management.
4. **Public policy engagement and multi-stakeholder initiatives:** Some investors may choose to express a voice in the public policy arena to extend their leverage and impact in addressing human rights—and to join forces with other like-minded investors. There have been numerous investor statements and public policy engagement initiatives on human rights issues.<sup>8</sup>

**How can managers, directors and investors achieve an understanding of how effectively a company is managing its human rights issues—and gauge the potential level of business risk that the firm is facing?**

Reporting on human rights issues is an important means for companies to build awareness, both internally and to external stakeholders, including investors, about how a company approaches the management and governance of these issues. This is relevant not only for company sustainability reporting, but also for integrated reporting in cases where human rights represent a material business or reputational risk. The Reporting and Assurance Frameworks Initiative (RAFI), discussed in greater detail in Appendix B, provides a comprehensive framework for executive management, directors and investors to understand a company's positioning on human rights issues and where gaps or vulnerabilities might lie. Companies that are subject to significant human rights risks may want to consider this approach both to guide internal awareness and external understanding of how the company is approaching or governing these issues.

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<sup>8</sup> Examples include: the US Securities & Exchange Commission (SEC) engagement on Section 1502 (Conflict Minerals Disclosure) of the Dodd-Frank Act of 2012, California Transparency in Supply Chain Act addressing human trafficking in supply chains, and the ICCR Bangladesh Investor Coalition to address systemic change in the apparel industry in Bangladesh following the Rana Plaza tragedy in April 2013. See further references in Appendix C.

## **Conclusion**

Human rights are an important issue for both companies and investors to consider, as a matter of both business ethics and enterprise risk management. The evolving expectations from a variety of stakeholders on how companies are managing human rights risks, the development of a robust reporting framework, and the direct link to investors under the OECD Principles, all contribute to human rights risks being an essential governance issue for investors, including ICGN members.

## **About ICGN Viewpoints**

ICGN Viewpoints provide opinion on emerging corporate governance issues and are intended to generate debate, whilst not defining a formal ICGN position on the subject. ICGN Viewpoints are produced by our member-led Policy Committees and we encourage dialogue by contacting Committee chairs directly or the ICGN Secretariat as follows:

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## **Appendix A**

### **The United Nations’ “Protect, Respect and Remedy” Framework for Business and Human Rights and its “Guiding Principles on Business and Human Rights”**

The United Nations’ “Protect, Respect and Remedy” Framework for Business and Human Rights and its “Guiding Principles on Business and Human Rights” have become the accepted global accountability frameworks to address human rights risks. The Guiding Principles were unanimously endorsed by the UN Human Rights Council in June 2011. Since the publication of the Principles on Business and Human Rights” in 2011, there have been rising expectations and greater visibility regarding corporate responsibility to respect human rights.

The Guiding Principles are founded on three pillars:

1. The state duty to **protect** human rights against abuse by third parties, including business through appropriate policies, legislation, regulation and adjudication;
2. The corporate responsibility to **respect** human rights, meaning to act with due diligence to avoid infringing on the rights of others and address adverse impacts with which they are involved;
3. The need for greater access by victims to effective **remedy**, both judicial and non-judicial.

At the core of the ‘corporate responsibility to respect’ is the implementation of human rights due diligence, which includes assessing actual and potential human rights impacts, integrating and acting upon the findings, tracking the effectiveness of actions taken to address human rights impacts, and communicating about how a company addresses risks and impacts

## **Appendix B**

### **UN Guiding Principles Reporting Framework<sup>9</sup>**

Many stakeholders including companies have asked for guidance on how to report on how they are implementing the UN Guiding Principles. The Reporting Framework was released on February 24, 2015. It was developed under the **Reporting and Assurance Frameworks Initiative (RAFI)** through an open, global, and consultative process. ICGN members have been part of several of these consultations since 2013. In September 2014 Unilever agreed to be the first company to pilot this reporting framework. Other early adopters include Ericsson<sup>10</sup>, H&M, Nestle and Newmont.

The Reporting Framework’s intent is to help companies meet evolving expectations for more and better public information about how they meet their responsibility to respect human rights. This goes beyond compliance with local, national and international laws and regulations. It focuses on a company’s human rights risks and impacts versus any activities that a company undertakes to advocate or promote human rights. The Framework is based on the UN Guiding Principles and therefore

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<sup>9</sup> <http://www.ungpreporting.org/>

<sup>10</sup> <http://www.ungpreporting.org/early-adopter-ericsson/>

focuses on a company's overarching commitment to and governance of human rights risk management. Companies that report using the Framework must identify salient human rights risks (defined as those risks that present severe risks to people) and then disclose information on the effective management of each salient risk identified. The Framework asks companies to identify salient human rights risks versus "material issues" that is commonly found when companies determine what to include in a corporate sustainability report is in line with the Global Reporting Initiative (GRI). RAFI defines "salient human rights risks" as "identified first and foremost based on the severity of potential human rights risks impacts, followed by their likelihood". Finally, the Framework asks, where necessary in the interest of concise and relevant reporting, that a company identify specific geographies for reporting on the salient risks identified, and why.

This framework can serve as a useful guide for investors to identify human rights risks in individual companies and to use as a guide for engagement on human rights issues. A \$4 trillion investor coalition have backed the Reporting Framework.<sup>11</sup>

## **Appendix C**

### **Select Examples of Human Rights Reporting Initiatives and Investor Action**

#### Investor Statement on Bangladesh Supply Chains

<http://www.iccr.org/investor-statement-bangladesh>

Global investor statements have played a critical role in raising awareness and support for promoting human rights. They have issued urgent calls to action, such as the one following the deaths of over 1,100 garment factory workers in the 2013 Rana Plaza tragedy in Bangladesh. The May 2013 investor statement coordinated by the Interfaith Center on Corporate Responsibility (ICCR) was signed by 200 global organizations from 16 countries with \$3.1 trillion in assets. It called for systemic change in the apparel industry and was used to engage 20 companies to join the Accord on Building and Fire Safety, and to support worker health and safety, factory remediation and worker rights.

#### California Transparency in Supply Chain Act of 2010

<http://www.state.gov/documents/organization/164934.pdf>

The California Transparency in Supply Chain Act of 2010 requires companies doing business in California with annual world-wide gross receipts that exceed \$100 million to report on what they are doing in their product supply chains to evaluate and address risks of trafficking and slavery, through audits, certification, internal accountability procedures and the training of supply chain personnel on trafficking and slavery. Companies were required to disclose as of January 2012. It was anticipated that over 3,000 businesses including non-US companies would be impacted by this disclosure rule.

#### UK Modern Slavery Law

<http://www.rathbonegreenbank.com/news/investors-support-inclusion-of-supply-chain-reporting-in-the-modern-slavery-bill>

In November 2014 a group of 20 global investors led by Rathbone Bank with a total of £940 billion in assets under management supported the inclusion of Transparency

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<sup>11</sup> <http://www.ungpreporting.org/early-adopters/investor-statement/>

in Supply Chains (TISC) legislation as part of the UK Modern Slavery Bill. This became law on March 26, 2014 by Royal Assent and is the first of its kind in Europe.

Section 1502 (Conflict Minerals Disclosure) of the Dodd-Frank Financial Reform & Consumer Protection Act

<https://www.sec.gov/about/laws/wallstreetreform-cpa.pdf>

The U.S. Securities and Exchange Commission (SEC) issued a final rule on August 22, 2012 for Section 1502 (Conflict Minerals Disclosure) of the Dodd-Frank Financial Reform & Consumer Protection Act. This requires US listed companies from the electronics industry and other sectors to trace and disclose its use of 'conflict minerals' (tin, tantalum, tungsten, or gold, also known as the "3TG") from the DRC or surrounding countries. The disclosure rule is expected to impact around 6,000 US listed companies (both domestic and international) with an average of 1,000 to 10,000 underlying suppliers per company.

US Conflict Minerals Multi-Stakeholder Group (RSN)

<http://www.sourcingnetwork.org/sec/>

Investors have worked collaboratively under multi-stakeholder initiatives which can drive broad, systemic change to advance human rights. One example is the Responsible Sourcing Network's initiative to address the U.S. Securities & Exchange Commission's rule-making process on conflict minerals (Section 1502 of the Dodd-Frank Act). For two years, this initiative brought together a core group of companies (AMD, HP, and Microsoft), investors, and human rights groups--including the Enough Project and Friends of the Congo--that met on a regular basis to develop a common framework and specific recommendations on conflict minerals disclosure requirements that are now a matter of public record. The influence and impact of this multi-stakeholder group was enriched by having investors at the table to base feedback through an investor and governance framework lens.

EU Conflict Minerals Rule (Pending)

<http://www.eurosif.org/investor-statement-on-eu-proposed-conflict-mineral-regulation/>

A conflict minerals bill is being debated in the European Parliament in December 2014 that would establish a voluntary versus mandatory framework and have a more limited company scope – only applying to companies that import 3TG or their ore into the European Union. Since December 2013 a group of global investors have highlighted the human rights risks and have advocated for alignment between the US and European disclosure rules. In their October 2014 statement sent to the European Commission, The European Council, and the European Parliament they "urge the consideration of amending the proposed regulation to ensure that it achieves its desired effect: to stimulate widespread, robust supply chain due diligence and reporting that will limit investor risk, to increase the region's legitimate extractive sector revenue streams, and help bring an end to the conflict in the DRC."

OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas

<http://www.oecd.org/daf/inv/mne/mining.htm>

The OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas provides detailed recommendations to help companies respect human rights and was endorsed in the final US Conflict Minerals Disclosure (Section 1502) rule as a "nationally or internationally recognised due diligence framework" for fulfilling Dodd-Frank requirements of conflict mineral due diligence.