
Human rights in investment

THE VALUE OF CONSIDERING HUMAN RIGHTS
IN ESG DUE DILIGENCE • APRIL 2017



Australian
Human Rights
Commission



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Foreword

Australian Human Rights Commission

The Australian Human Rights Commission is pleased to launch *Human rights in investment* in collaboration with EY.

The aim of this perhaps unlikely collaboration has been to explore the idea that due diligence underpinning investment decisions should include their impact on human rights.

It is true that businesses in Australia increasingly understand that to respect human rights is good for business. Research also demonstrates that there is a direct relationship between the financial performance of a business and treating its employees and customers with respect and dignity.

It is also true that, while institutional investors, such as asset owners and asset managers, take environmental, social and governance matters into account, they are reluctant to consider human rights when making investment decisions. Some investors believe they are prevented from doing by so their fiduciary duty to maximise returns to beneficiaries. Others find human rights issues too abstract and are not sure where or how to start to consider them as part of an investment choice.

You might ask what the Australian Human Rights Commission can add to this discussion. In fact, the Commission knows how important the business community is to the implementation of human rights. About two thirds of the complaints we receive, and attempt to conciliate concern, fair and non-discriminatory access to employment and to goods and services. In short, business is both a cause of many human rights breaches in Australia and the solution to protecting these rights.

The aim of this leadership paper is to debunk the myth that human rights and investment practices are incompatible. Rather, the paper illustrates how they go hand in hand. Human rights, just as any other aspect of business, can increase the value of an organisation if managed appropriately, or decrease it, if neglected. Investors' key role to protect and enhance people's savings to enable them to retire with dignity is not only aligned with, but also based in fundamental human rights.

We hope this paper helps investors to understand how human rights compliance can bring significant opportunities for business and complement their core investment values.

We wish to thank EY for working with us on this initiative.



Professor Gillian Triggs

President

EY

Ask investors if it is important to consider political risk in investment decision-making and they will tell you that, quite obviously, it is. Ask them instead if it is important to consider human rights in investment decision-making and some will tell you that, while human rights are important, it is not always possible or even permissible to consider them in practice. To me, this doesn't make much sense. Human rights risks *are* political risks. Human rights laws and norms are largely a political construct, administered by government and civil society. Excluding human rights risks from the universe of political risks renders the latter significantly incomplete.

I believe that we are entering a period in which the link between human rights and political risk mitigation in investment decision-making will become clearer. As the politics of inequality drives increasing scrutiny towards imbalances of power, the social licence of investees – their compatibility with prevailing social norms – will become a key indicator of value and resilience. In an environment where the legality of an action or business model is not necessarily an indicator of its social acceptability, human rights will become an increasingly universal benchmark for assessing the capacity of an investee to maintain their social licence into the future.

This report seeks to confirm the permissibility and practicability of considering human rights in investment decision making, and includes the assertions of some leading Australian investors. It acknowledges that while the analysis of human rights is far from easy, there is enough commonality between leading approaches to offer a roadmap to any investor looking to further integrate human rights into their diligence and active management processes.

We thank the Australian Human Rights Commission for the opportunity to work with them on this publication and we hope you find it useful.



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Abbreviations

ACSI	Australian Council of Superannuation Investors
AHRC	Australian Human Rights Commission
AIST	Australian Institute of Superannuation Trustees
APRA	Australian Prudential Regulatory Authority
ASX	Australian Stock Exchange
CFAI	Chartered Financial Analyst Institute
CHRBI	Corporate Human Rights Benchmark Initiative
EP	Equator Principles
ESG	Environmental, Social and Governance
EU	European Union
GCNA	UN Global Compact Network Australia
GRI	Global Reporting Initiative
NBIM	Norges Bank Investment Management
OECD	Organisation for Economic Co-operation and Development
OECD MNE	OECD Guidelines for Multinational Corporations
RSE	Registrable Superannuation Entity
RIAA	Responsible Investment Association of Australasia
UNEP FI	United Nations Environment Programme Finance Initiative
UNGPs	United Nations Guiding Principles on Business and Human Rights UN PRI United Nations Principles for Responsible Investment

1. Introduction

This paper examines the incorporation of human rights-related matters into investment decision making. The consideration of human rights in this context forms part of a global trend relating to the integration of environmental, social and governance ('ESG') factors into investment decision making. While there has been extensive analysis of the merits and methodologies of ESG integration more broadly, there has been limited analysis of the subject of human rights specifically. This reflects the relative complexity of human rights issues within the broader universe of ESG risks and, by association, the greater potential for investors to not fully acknowledge the relevance and practicality of human rights to the business of investing.

The aim of this paper is to address and, as far as possible, dispel any residual concerns that the systematic consideration of human rights in investment decision making is incompatible with the methods and mandates of investors.

Specifically it seeks to:

- offer an explanation for our view that asset owners and managers not only can, but should consider human rights risks for their investments
- provide an update on recent international developments on the definition of fiduciary duties with regard to ESG factors and human rights, as it pertains to asset owners in Australia
- consider the extent to which human rights are being considered by asset owners and managers and industry organisations in Australia
- share the views on human rights in investment by four mainstream Australian investors²
- identify barriers to the consideration of human rights in investment decision processes and suggest ways to address them, and
- provide practical guidance and examples of leading practice for integrating the consideration of human rights into investment governance and decision-making practices of asset owners in Australia.



2. Human rights in ESG investment practice

The Australian business community has taken clear steps in recent years to embed the consideration of ESG factors into decision-making processes. This includes the investment community, which has seen a notable uplift in the integration of ESG factors in investment decision making and in its uptake of 'responsible investment'.

Much of this progress has been driven by an acknowledgement that ESG integration is an extension of risk management. Whilst human rights issues are considered a material risk for some sectors, the dominance of other ESG issues (e.g. climate change, corruption and ethics) and the difficulty in monetising human rights risks, may have overshadowed its importance in investment governance and decision-making. Notwithstanding this, the consideration of human rights in business is taking on a new prominence: in 2016, 32% of investors say that they would immediately rule out an investment if there were evidence of human rights risks, against 19% in 2015.³ In recognition of this, the leading principles establishing companies' obligation to respect human rights, the United Nations Guiding Principles on Business and Human Rights (UNGPs), are increasingly being looked to as authoritative guidance and being incorporated into binding international standards.⁴

The extent to which ESG risks are considered in investment decision-making has likely been influenced, in part, by how far asset owners have considered it permissible to do so under fiduciary law as it pertains to the governance of trusts and other investments vehicles. In the last five years, a number of national and international developments may have contributed to clarifying fiduciary duty and ESG, reaffirming that the consideration of ESG risks is permissible and indeed required.⁵

In line with international trends, there has been a steady increase of the mainstreaming of ESG into investment governance in Australia and around the world:

- Globally, the number of signatories to the UN Principles for Responsible Investment (PRI) has increased by more than 1400 since 2006. To date 34 asset owners, 72 investment managers, and 13 Service Providers in Australia have committed to the Principles.⁶
- There has been a significant increase in responsible investment among funds under management, with funds that undergo some form of ESG integration or screening totalling \$633.2 billion at the end of 2015, 47% of all assets professionally managed in Australia.⁷
- Across one, three, five and 10 year spans, core responsible investment funds outperformed the ASX300 and the average large cap Australian equities funds.⁸
- The importance of ESG has also been brought to the fore through a number of non-government organisation-led divestment campaigns around the risk of stranded assets from climate change. Similar campaigns on human rights risks at home in Australia have also occurred.

Whilst there may still be some reticence by trustees to fully embrace the concept, the current Australian prudential regulation (*Superannuation Industry (Supervision) Act 1993* (Cth), ss 62 and 65) and Australian Prudential Regulation Authority (APRA) Investment Governance Prudential Standard (SP530) (ss 34, 35 and 36) permits the consideration of ESG issues in investment processes. Recent developments in the US, European Union (EU) and Australia only serve to reinforce the fact that the trend is towards more ESG integration, not less.

3. Fiduciary duty and ESG status quo

The consideration of human rights in investment decision-making is largely considered within the broader ESG and fiduciary duty dialogue that has evolved over the last two decades. A key issue in the past has revolved around the extent to which fiduciaries can consider non-financial issues, or whether doing so would be a breach of the 'prudent person' or 'sole benefits' test.

This discussion has been informed by specific financial regulations, case law, government inquiries and interpretative guidelines issued by regulatory bodies in the US, EU and Australia. The debate has also been informed by the findings from research undertaken by international agencies in collaboration with industry.

Recent international developments

One of the most comprehensive analyses of ESG and fiduciary duty is the recent joint study undertaken by UNEP Finance Initiative, UN PRI and the United Nations Global Compact to 'end the debate about whether fiduciary duty is a legitimate barrier to investors integrating environmental, social and governance (ESG) issues into their investment processes.' The study provides an update of developments since the landmark 2005 Freshfields Bruckhaus Deringer report,⁹ and details analysis of industry developments and regulatory changes for eight global jurisdictions.

The report concluded that:

'Failing to consider long-term investment value drivers, which include environmental, social and governance issues, in investment practice is a failure of fiduciary duty'.¹⁰

This statement is supported by a number of Australian investors who consider human rights in companies' direct operations or in their supply chains in the same way as any other risks and opportunities. For example, one of the asset managers interviewed for this report believes that management of human rights issues can be seen as a proxy for management quality of a company, which is always an important aspect of investment considerations.

United States

The US has been at the forefront of the debate on ESG and fiduciary duty and much of this revolves around the various interpretations of 'prudent person' test and its incorporation and subsequent interpretation as part of the *Employee Retirement Income Security Act of 1974 (ERISA)* and the *Uniform Prudent Investor Act of 1994 (UPIA)*. The Federal Department of Labour has issued guidance statements on the matter over the last 30 years and it is significant to note that in October 2015, it issued a new 'Interpretive Bulletin Relating to the Fiduciary Standard under ERISA in Considering Economically Targeted Investments'.¹¹



The bulletin revoked its 2008 statement and invoked its original 1994 statement, indicating that consistent with fiduciaries' obligations to choose economically superior investments, the Department does not believe ERISA prohibits a fiduciary from incorporating ESG factors in investment policy statements or integrating ESG-related tools, metrics and analyses to evaluate an investment's risk or returns.

European Union

The EU has been a leader for over a decade when it comes to ESG integration, with efforts being stepped up in the wake of the global financial crisis. Ten of 14 jurisdictions where pension funds are required to disclose information on their ESG approach are located in Europe. Several countries, including the Netherlands and the UK have clarified that there is no conflict between fiduciary obligations and the consideration of material sustainability factors in the investment process.¹²

At the level of the Union, the importance accorded to non-financial reporting and ESG, is reflected in the binding nature of the Directive 2014/95/EU on the disclosure of non-financial and diversity information (NFR Directive), which all EU Member States were bound to enact in national law by December 2016. When it comes specifically to ESG in investment, the European Commission ran a public consultation 'on long-term and sustainable investment', specifically targeting Institutional Investors, asset managers, and other service providers.¹³ More broadly, changing societal expectations in the EU, in line with political and economic realities, are driving the demand for financial institutions to recognise their responsibility towards current and future generations from an environmental and social perspective.

Australia

In the past 12 months, 68% of investors worldwide report that non-financial performance has played a part in their investment decisions at least occasionally, a step up from 52% in the previous year.¹⁴ In Australia, 82.6% of investors considered non-financial factors relevant across all industry sectors in 2015.¹⁵

Fiduciary duties in Australia for a range of investment vehicles are governed by a number of key regulations and regulatory guidelines, namely:

1. **Corporations Act 2001 (Cth) (Corporations Act)**¹⁶ – states that decision makers are subject to directors' duties, including: (a) exercising their powers and discharging their duties with the degree of care and diligence that a reasonable person would exercise if they were in that director or officer's role, (b) exercising their powers and discharging their duties in good faith in the best interests of the corporation and for a proper purpose, and (c) not improperly using their position to gain an advantage for themselves or someone else or to cause detriment to the corporation.
2. The **Australian Superannuation Industry (Supervision) Act 1993 (Cth) (SIS Act)**¹⁷ – section 62 requires trustees to act honestly, to properly invest funds, to act in the best interests of the beneficiaries and to exercise a prescribed standard of care, skill and diligence and to give priority to beneficiaries where there is a conflict of interest.
3. The **Australian Prudential Regulatory Authority – Prudential Practice Guide on Investment Governance (SPG 530)**¹⁸ – indicates that a registerable superannuation entity (RSE) may adopt an investment strategy that has an ESG focus, so long as it can demonstrate appropriate analysis to support its formulation (including being mindful of exposing the interests of beneficiaries to undue risk).

Section 34 states that an RSE licensee may take additional factors into account where there is no conflict with the requirements in the SIS Act, including the requirement to act in the best interests of beneficiaries. This may result in the RSE licensee offering an 'ethical' investment option to beneficiaries to reflect this approach.

The Australian Prudential Regulation Authority sees no inherent conflict in super funds excluding investments on ethical grounds and complying with their fiduciary duties.¹⁹

4. **Australian Securities and Investment Commission Regulatory Guide 65 (2011)**²⁰ – Section 1013DA requires financial product issuers with an investment component that claims that labour standards and environmental, social or ethical considerations are taken into account, to disclose how this has been taken into account in selecting, retaining or realising the investment.
5. **Improving superannuation transparency** – the Australian Government’s Treasury has prepared exposure draft legislation for public comment to amend the *Corporations Act* to establish legislative frameworks for superannuation choice product dashboards and portfolio holdings disclosure. Whilst not specifically aimed at ESG disclosures, the proposed legislation may assist members in gaining additional insights into the nature of their underlying investments.

In addition, to the above regulatory measures, a number of industry organisations have issued their own guidance on the consideration of ESG, namely:

- **Financial Services Council: *Standard No. 20 Superannuation Governance Policy* (2013)**
- **Australian Council of Superannuation Investors/Financial Services Council: *ESG Reporting Guidelines for Australian Companies* (2015)**
- **Australian Institute of Superannuation Trustees/Industry Funds Forum: *2014 Fund Governance Framework for Not-for-Profit Superannuation Funds***
- **Centre for Policy Development (2016)**

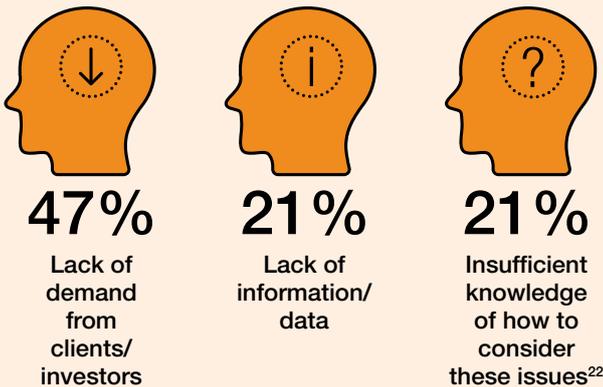
In practice, fiduciary duty demands that conduct must be directed towards beneficiaries’ best interests, and due process and competence must be applied in decision-making. This is likely to require trustees to show that they have identified and assessed ESG-related risks to companies and to their portfolios, to have adopted specific measures to manage these risks, and to have challenged company management. Among the investors we interviewed, it appeared that fiduciary duty laws in Australia are considered adequate since directors are required to consider all material risks and ESG risks, including human rights.



4. Challenges to human rights considerations in investment

In 2015, the Chartered Financial Analyst (CFA) Institute surveyed 1,325 asset managers on the ESG issues²¹ and identified a number of challenges to integration of human rights in investment. Seventy-three percent, or 967 of the surveyed asset managers, take into account ESG factors and of them, less than 50% consider social issues such as human rights, as relevant.

The 23% of the survey respondents who did not consider ESG issues named the following key reasons:



In trying to better understand these findings, we spoke to a number of investors and fund managers across Australia. They cited the following reasons as impediments to ESG and with that human rights considerations:

- Lack of understanding of fiduciary duty laws and requirement to consider ESG and human rights risks;
- Confusing ESG and human rights considerations with ethics and thinking there is a financial trade off in considering human rights risks;
- Complexity of human rights issues and time, knowledge and resources required to understand them;
- Difficult access to human rights information and inadequate corporate disclosure on human rights.

Additionally, we observed different investor attitudes towards using the language of human rights in their engagement with companies. For some investors, including one we interviewed, human rights issues can be assessed in a number of ways when looking at a company 'it's not just about breaches of international human rights law, it can be about assessing labour standards, supply chain risk, occupational health and safety, working conditions, wages fraud in franchising. Using accessible language that companies can relate to in the context of their operations is important when engaging on human rights issues. The language needs to be practical and make sense to the people you are talking to in the context of their business operations'. Others find human rights too broad and instead refer to specific examples to ensure human rights risks are managed by businesses. Ultimately, the objective is to avoid adverse human rights impacts and language should be used that is understood by relevant stakeholders and helps meet this aim.

Our interviews with investors partially confirmed the view that clients do not demand proper attention to human rights. However, this appears to depend greatly on client profiles. While some super funds receive questions by members about ESG or human rights issues on an almost daily basis, others have a passive membership base with limited interest in or understanding of these – or any other issues. Understanding what shareholders want seems to be a complex and difficult question. There is no *one type* of shareholder, and each one is likely to approach their investments differently. AMP Capital summarise this complexity:

*'The more time we have spent speaking to companies about their priorities, the clearer it has become that companies are under enormous pressure to deliver a complicated, and often mutually exclusive, set of outcomes for their diverse shareholders. Some shareholders see 'shareholder value' as determined by the daily news stream, while for others it is much more about the company's long-term prospects.'*²³

In the remainder of this paper, we discuss the what, the why, and the how in relation to including human rights in investment decisions. We put forward the premise that there is no formal impediment to putting human rights on an equal footing with other ESG considerations.

5. The United Nations Guiding Principles on Business and Human Rights

The United Nations Guiding Principles for Business and Human Rights (UNGPs) provide a ready platform for asset owners and managers to develop coherent management responses to respecting human rights in line with their fiduciary duty.

A number of global voluntary finance sector-specific industry initiatives have established principles, guidelines, and tools for assessing ESG risks, including social risks in the finance sector (e.g. the United Nations Environment Programme (UNEP) Finance Initiative, the Equator Principles and the UN Principles for Responsible Investment (UNPRI)). Most of these initiatives include some aspects of human rights, but it was the adoption of the UNGPs by the UN Human Rights Council in 2011 that put human rights definitively on the radar for business, including for the finance sector.

The UNGPs established a framework for businesses and governments to address and prevent human rights impacts associated with business activity. They are founded on three pillars:

1. States' duty to protect individuals against human rights abuses
2. Businesses' responsibility to respect human rights – by embedding due diligence in their processes to avoid infringing the rights of others and to address adverse impacts that they are involved in, and
3. The requirement for any party involved in adverse human rights impacts to facilitate appropriate and effective remedies for those affected by business related human rights abuses.

Under the UNGPs 'human rights' include, at a minimum, those rights contained in the International Bill of Human Rights²⁴ and the International Labour Organisation's Declaration on Fundamental Principles and Rights at Work.

Investors have a direct impact on human rights, through their employment standards and their contracts with service providers, for example. However, they may have a far greater indirect impact through their value chains – via the capital and other financial products and services they provide to other businesses.

According to the UNGPs companies are required to conduct human rights due diligence in their investment decision making process to ensure they are not complicit in human rights abuses:

'The responsibility to respect human rights requires that business enterprises seek to prevent or mitigate adverse human rights impacts that are directly linked to their operations, products or services by their business relationships, even if they have not contributed to those impacts.'

The UNGPs have enjoyed a widespread uptake and have rapidly become the leading reference for human rights and business. There is also a movement among some countries represented in the Human Rights Council to move towards a binding international treaty on business responsibility with regard to human rights, though it is unlikely to be achieved in the near term.

Leading members of the investor community have kept pace with these developments and expressed support for the UNGPs early on. A statement, signed by 29 investors (collectively representing US\$ 2.7 trillion assets under management) called upon companies to implement the UNGPs and identified the 'protect, respect, remedy' framework and the Principles as 'useful tools in [their] analysis of how companies address human rights risks' and helpful in evaluation of the 'quality of corporate approaches and performance'.²⁵

The Australian Federal Government co-sponsored the United Nations Human Rights Council resolution to endorse the UNGPs, and is currently considering whether and how a National Action Plan on Business and Human Rights might be introduced.

6. The business case for considering human rights in investment decisions

While asset owners vary in their investment philosophies and strategies to meet their fiduciary duty, there are a number of compelling arguments for integrating human rights in their decisions. These include the financial risks (fines, legal action, lowered financial performance), reputational risks (customer loyalty, brand integrity) and compliance risks that human rights present to the companies in which they decide to invest.

From our discussions, we also heard from several of the asset managers that failing to respect human rights inevitably tends to cost money in the longer term. We were told that ‘management of human rights risks is a proxy for management quality’²⁶ and well-managed companies are those that perform best. It was argued that fiduciary duty may well *require* an investor to reconsider an investment based on human rights risks, even if it is performing well at that stage, because human rights risks in the longer term could lead to public controversy and an erosion of its social license to operate, which can also affect share value.

Companies regularly suffer losses as a result of failing to appropriately consider human rights in conducting their businesses, affecting their share price in the process.²⁷ Some examples of how human rights issues may expose companies to financial costs are:

Corporate financial performance

In a meta-study of more than 200 academic studies, industry reports, newspaper articles, and books, the University of Oxford and Arabesque Asset Management showed that 88% of research found that solid ESG practices result in better operational performance and 80% found that it has a positive influence on stock price performance.²⁸ The study considers the collective ESG performance, but also the individual impact of good ‘E’, ‘S’ and ‘G’ management. This is borne out in the Australian context by EY’s findings in the 2015 Responsible Investment Association of Australasia’s Annual Benchmark Report²⁹ that the average responsible investment fund outperformed market benchmarks (Figure 1).

Lawsuits

A large number of cases are brought against businesses around the world on human rights grounds, mainly civil cases. Many of these are addressed through domestic law on discrimination, privacy, employment rights, or health and safety. Of the landmark cases brought against multinational companies, many end in settlement.³⁰

Fines

The Brazilian Institute of Environment and Renewable Natural Resources recently fined 35 companies, mostly domestic cosmetic and pharmaceutical multinationals, 88 million Brazilian reals (around US\$44 million) for not sharing their profits with Indigenous communities, illustrating the importance of the rights of Indigenous Peoples.³¹

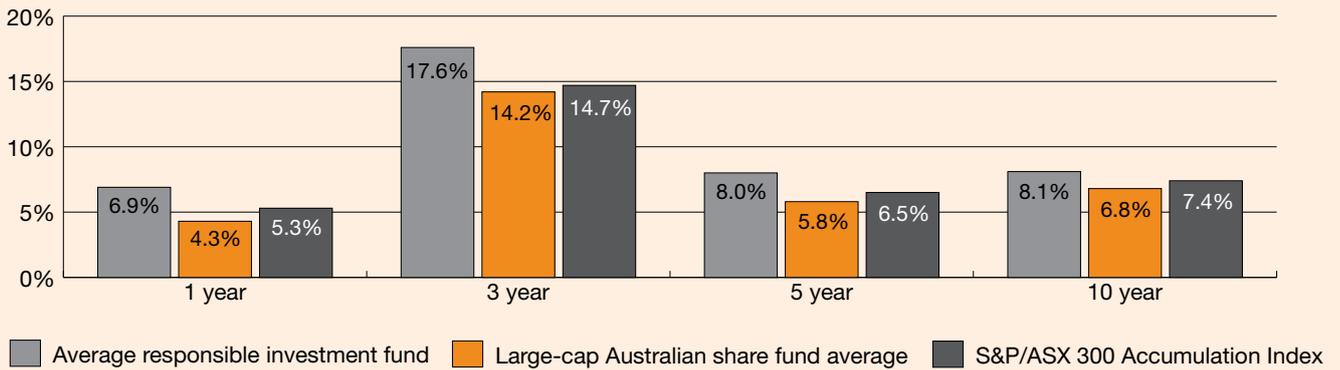
Disruption of operations

Drawing on figures from the mining industry, where a small number of projects have been impeded by protests or social controversy, Professor John Ruggie pointed out that: ‘For a world-class mining operation, which requires about \$3-5 billion capital cost to get started, there’s a cost between \$20 million and \$30 million a week for operational disruptions by communities’.³²

Reputational damage

Companies can cause or contribute to adverse human rights impacts both in their operations and in their value chain. A 2009 study³³ found US and UK firms experienced significant negative abnormal returns when news items reporting human rights abuses became publicly known. Other costs also include time and resources of staff and senior management spent dealing with allegations of human rights abuse (investigating, responding, and reporting to stakeholders, investors, the press and the public).

Figure 1: 2014 Average responsible investment performance vs market benchmarks



The ethical behaviour of a company is increasingly important to consumers, especially among Generation Z and Millennial consumers³⁴ and brand image therefore continues to matter. According to a survey by *The Economist* in 2015: 'The business case for respecting human rights tends to rest on behaving ethically and maintaining good relations with employees and others, rather than on short-term risk management or financial considerations. The main driver is 'building sustainable relationships with local communities'.³⁵

Divestment

The Norwegian Government Pension Fund (Norges Bank Investment Management or NBIM), a major sovereign wealth fund, has divested or withheld funds from a range of companies on human rights and ethical grounds. The fund's investment policy includes strict ethical rules with a focus on sustainable economic, environmental, and social development. Its decisions are public and elaborated, which means a company could lose not only capital investment, but also risks reputational damage and reduced access to further capital.³⁶



7. What does respecting human rights look like for asset owners?

Based on the considerations set out in this paper, there is a range of incentives for business organisations, including asset owners, to respect human rights. They stem from:

- Legal requirements as defined by human rights provisions in Australian common law and legislation and in line with international human rights instruments that have been ratified by Australia;
- Internationally agreed human rights principles and guidelines, e.g. UNGPs, OECD MNE Guidelines;³⁷ and
- International leading practice standards and tools developed by industry groups and non-governmental organisations e.g. the UN Global Compact, UNPRI, UN Guiding Principles Reporting Framework Investor Statement,³⁸ Thun Group Principles.

While legal obligations, such as compliance with Australian laws prohibiting discrimination and protecting human rights in their direct operations, or the obligations that come with fiduciary duty, usually mandate clear actions, putting principles and guidelines into practice may often seem more nebulous to companies that do not have in-house specialists in the field.

The UNGPs still likely provide the most appropriate framework for determining what is expected of companies when it comes to respecting human rights. In essence, it is important to ‘know and show’ due consideration of human rights. ‘Knowing’ involves putting processes in place to identify and screen for risks of human rights impacts. This includes the full human rights due diligence process as set out in the UNGPs. ‘Showing’ due consideration for human rights could include transparency in reporting, having appropriate grievance mechanisms, outlining further commitments – such as no tolerance for land grabs or child labour, and other public measures.

Guiding Principle 15 sets out the essence of what a business should have in place, namely:

- (a) A policy commitment to meet their responsibility to respect human rights;
- (b) A human rights due-diligence process to identify, prevent, mitigate and account for how they address their impacts on human rights; and

- (c) Processes to enable the remediation of any adverse human rights impacts they cause or to which they contribute.

Human rights due diligence has a broad scope that constitutes a cycle of research, stakeholder engagement, risk identification and mitigation, monitoring and reporting on a continuing basis. In carrying out due diligence, depending on its particular investment philosophy, an investor might consider the following responses:

1. Pre-investment due diligence – **Identify the risk** of the investee causing or contributing to adverse human rights impacts, through research and consultations. Prior to investing, assess the extent to which potential adverse human rights impacts and risks would materially negatively impact on the investee’s performance and portfolio returns. Decide whether to invest, discard the opportunity, or engage with the proposed investee to bring about sufficient change to allow investment to go ahead.
2. Post investment engagement:
 - **Monitor** the investee company for any changes in its behaviour, policies or business operations
 - **Actively engage** with the investee company and use influence (along the lines suggested by the UNGPs and the PRI) to improve performance and potential returns; or
 - **Divest** as a last resort and replace shareholding with an alternative asset with the same or better risk/return/liquidity profile in line with investment strategy.³⁹

From a fiduciary duty perspective, asset owners’ decisions to divest appear to have mainly been driven by long-term risk perspective and only occasionally by moral imperatives, where the basis has been that other alternative investments, offering a similar risk-return profile were preferred. Investors we engaged with were advocates for engagement and would either not divest or use divestment as a very last resort. One of the investors we interviewed explained that ‘selling out of the company may not lead to an improvement’ and engagement with companies on human rights issues is key to a better human rights practice and, with that, better investment outcomes.

A note on divestment campaigns

A number of recent divestment campaigns in Australia have generated considerable interest and thrown up questions about the related exercise of fiduciary duty. The most prominent of these has been the fossil fuel divestment campaign (e.g. 350.org,⁴⁰ Markets for Change⁴¹ and the Asset Owners Disclosure Project).⁴² The other two, which have more of a human rights focus, are the divestment campaigns pertaining to tobacco manufacturing (Tobacco Free Portfolios) and to companies operating offshore regional processing centres for asylum seekers on behalf of the Federal Government (No Business in Abuse).⁴³

In explaining the rationale for divesting from an ASX listed company contracted by the Australian government to operate offshore detention centres for asylum seekers, NGS Super Chief Executive Anthony Rodwell-Ball said the divestment decision was made on moral grounds but could be justified on economic grounds. This was because NGS 'will actively seek replacement sources of earnings and growth in the market, such that our members' retirement outcomes will not be prejudiced by the decision'.⁴⁴ The interviews with investors confirm that companies that fail to manage and address human rights issues risk the loss of financial returns in the long term.

Like all businesses, institutional investors, including minority shareholders,⁴⁵ are expected to respect human rights in their operations, but also in their broader value chain. This requires thorough knowledge of clients, assets, and suppliers. This is particularly difficult for the financial services sector, which touches on the vast majority of regions, activities and industries. A number of collaborations between financial institutions, industry associations, multilateral agencies and non-government organisations are currently underway to define more precisely what the obligations of financial institutions are to 'prevent and mitigate' adverse human rights impacts.

One of the most important is the Proactive Agenda Project on Responsible Business Conduct in the Finance Sector of the OECD. In that context, the 2016 Global Forum on Responsible Business Conduct included a session on how financial institutions and financial service providers are using their leverage to promote responsible business among their clients and in their own operations. The session gave credence to the point made above, that longer-term thinking in markets is likely to narrow the perceived gap between fiduciary duty and ESG considerations.⁴⁶

In Australia, while there is substantial guidance on ESG and investing⁴⁷ and specific human rights research aimed at engaging with and improving investee company performance,⁴⁸ there is still limited detailed guidance for asset managers on how to apply the UNGPs and integrate human rights provisions into their investment policies and decision-making processes.

Investors, possibly working together with specialised organisations, are encouraged to develop further questions on substantive human rights issues that are relevant to each asset type, to seek to ensure they are addressing the key issues for the class, industry and country. Examples might include:

- Investments in real estate carrying specific risks related to land acquisition, including displacement and relocation and claims of vulnerable groups, which requires due diligence on the effective use of the principle of Free Prior and Informed Consent (FPIC).⁴⁹
- Investments in agribusiness in emerging markets should be investigated for adverse impacts on a range of human rights related to the right to land, food, and water, as well as the labour rights of vulnerable groups including migrant workers and children.
- Investments in sovereign debt, by supporting undemocratic regimes, can foster human rights abuses, as well as the non-achievement of economic and social rights such as the right to education and the right to health.⁵⁰

8. Leading practice examples

The assessment of social impacts, including human rights impacts, by asset owners has existed for many decades. Some of the early pioneers included leading public sector pension schemes and ‘faith-based’ investors, which aligned to international boycotts and sanctions associated with ending apartheid in South Africa in the seventies for example (e.g. The California Public Employees’ Retirement System, CalPERS, includes the Sullivan Principles as one of its current human rights standards). This approach gradually broadened in scope and garnered support from a wider group of institutional investors, focusing on engagement and divestment campaigns associated with unfair labour practices in the branded apparel sector and abuses of security forces used by large oil and mining companies in developing countries among other issues.

Nevertheless, the investor response to human rights abuses has remained largely reactive and still stops short of universal acceptance. Despite the growing international presence of specialised organisations such as the Danish Institute for Human Rights, or the Institute for Business and Human Rights, and the proliferation of tools and guidance, it often takes specific campaigns or incidents for concrete action to ensue. The Rana Plaza factory collapse in 2013, which killed more than 1200 people, is one of few industrial accidents to have triggered such a resonating response. Even that response, according to some, has only partially delivered long-term behavioural change.⁵¹

As before, a number of pioneers are choosing to implement robust human rights due diligence, based on the notion that this is the way of the future. Below, we set out a number of examples of asset managers leading in the field of respecting human rights, both abroad and in Australia. These may provide some inspiration for Australian asset managers to refine their policies and management processes to embrace the respect for human rights.

International examples of leading practice

CalPERS’s Global Governance Principles⁵² highlights the importance of human rights

CalPERS is one the largest pension schemes in the US (with assets totalling \$315.98 billion as of April 13, 2017)⁵³ and is internationally recognised for its comprehensive approach to ESG, shareholder activism and human rights. ESG and human rights are an integral part of CalPERS’ investment beliefs and values required for long-term value creation. Human Rights provisions feature prominently in CalPERS’ Global Governance Principles and Investment Beliefs to the extent that they state that ‘Corporations should adopt maximum progressive practices toward the elimination of human rights violations in all countries or environments in which the company operates.’ They go on to specify that ‘these practices should emphasize and focus on preventing discrimination and/or violence based on race, colour, religion, national origin, age, disability, sexual orientation, gender identity, marital status, or any other status protected by laws or regulations in areas of a company’s operation.’

Norges Bank Investment Management clarifies its expectations of corporate behaviour on human rights

Norges Bank Investment Management (NBIM), a separate part of Norges Bank (Norway’s Central Bank) is responsible for the operational management of the Government Pension Fund Global (\$7.244 trillion in 2016).⁵⁴ Its charter is set by the Norwegian parliament. NBIM has been at the forefront of responsible investment and in March 2015 NBIM published new guidance on human rights – *Human Rights: Expectations Towards Companies*.⁵⁵

It specifically addresses boards, saying: ‘Our expectations are primarily directed at company boards and intended to serve as a starting point for our interaction with companies on the topic of human rights.’ Boards should understand the broader environmental and social consequences of business operations, and must set their own priorities accordingly and account for the associated outcomes.



Best Practice

NBIM requires that they should ensure the company has a policy to respect human rights and that relevant measures are integrated into corporate business strategy, risk management and reporting. Strategies for responsible business conduct should follow the UN UNGPs for Business and Human Rights, where applicable.

Swedish public sector employee pension schemes leads on ESG stewardship, including human rights

The Ethical Council is a collaboration between four of the buffer funds in the national Swedish pension system, (Total AUD 150.5 Billion). The Council's guiding principle is to make a difference by acting as strategically accountable and committed owners who exert influence on companies around the world to improve their efforts on environmental and social issues.⁵⁶

As part of the Swedish pension system, the pension funds rest on the same principles of commitment, action and demand for change as those that form the core values of the Swedish state. Central tenets of these values include democracy, the equal value of all people, the freedom and dignity of the individual and sustainable development, in accordance with the wording of the Instrument of Government. The Swedish Government's core values also find expression in those international conventions that Sweden has signed, which include conventions on the environment, human rights, labour law, corruption and inhumane weapons, as well as through the support given to initiatives such as the United Nations Global Compact and OECD Guidelines for Multinational Enterprises.⁵⁷ The Council's proactive approach to active ownership and stewardship is highlighted in their 2014 annual report.⁵⁸

UN PRI leads collaborative engagement of the extractives and agricultural industry on human rights⁵⁹

The United Nations-supported Principles for Responsible Investment (PRI) initiative is an international network of investors working together to put the six Principles for Responsible Investment into practice. PRI is currently coordinating two sector-specific collaborative investor engagements, which align closely with the UNGPs.

PRI-coordinated engagement on human rights in the extractive sector

Violation of human rights by extractive companies has received significant attention by the media and civil society. Through this collaborative engagement, 49 investors with US\$7.8 trillion assets under management are engaging 32 global oil and gas and mining companies on human rights issues. Through dialogue with investee companies, investors are seeking to improve companies' implementation of the UNGPs and to their disclosures on human rights. All the companies that have been contacted to date have responded, including three Chinese companies.

Tools for investors:

- 2015 PRI engagement guide – 'Human rights and the extractive industry: Why, who and how to engage' also includes resources such as country specific human rights issues and practices, and company specific human rights disclosure.

PRI-coordinated engagement on labour practices in agricultural supply chains

The increasing attention to forced labour and modern slavery has shone the spotlight on agricultural practices in many countries that supply large food and beverage companies. Since 2013, the PRI has coordinated a collaborative engagement with food and beverage companies on this issue. To date, it has resulted in 23 of 34 target companies improving their reporting and often their related practices.⁶⁰ PRI signatories are now developing a further phase of work, and investors are invited to get involved.

Tools for investors:

- Investor expectations on labour practices in agricultural supply chains (1-2 page overview of expectations, signed by global investors)⁶¹
- Labour practices in agricultural supply chains: An investor guide.⁶²

Australian examples of leading practice

To provide a perspective on Australia, we considered the human rights disclosures of the 34 Australian asset owners that are PRI signatories, 11 other leading asset managers, as well as analysis from the Responsible Investment Association of Australia's *Benchmark Report 2015*. The results are illustrated in Figure 2, Figure 3 and Figure 4 opposite:

This landscape is further illustrated by RIAA's *Superfund Responsible Investment Benchmark Report 2016*,⁶³ which looked at whether superannuation funds are committed to international norms and conventions, by fund category.⁶⁴ The UN Global Compact⁶⁵ and the PRI were the key norms which responding superfunds referenced in their responsible investment approaches. It was shown that industry funds are leading in taking human rights related international norms and conventions into consideration as part of their investment decision making. See Figure 4.

Beyond the declared integration of human rights into governance processes and investment decisions, there are examples of Australian investors being recognised for their application of the principles.

The Future Fund and the Australian Government's international treaty obligations

The Future Fund, Australia's AU\$118bn sovereign wealth fund, was voted the 2016 Sovereign Wealth Fund of the Year by the Central Banking Journal. The Fund's Board policy on Ownership Rights and ESG Risk Management⁶⁶ is included in its Statement of Investment Policies and provides as follows:

The Board believes that effective management of material financial and reputational risks and opportunities related to ESG issues will, over the long term, support its requirement to maximise returns earned on the Funds. The Board builds this perspective into its investment decision-making, including the management of ownership rights, and into its processes for selecting the external investment managers responsible for individual investment decisions.

The Board also seeks to influence its investee governance arrangements through exercising its ownership rights. In instances where the entity is not responding appropriately, the Board may exclude the investment from the portfolio. The Board publically discloses the Fund's top 100 equity holdings.

Australian Council for Superannuation Investors on labour and human rights risks in supply-chain sourcing

The Australian Council for Superannuation Investors (ACSI) released research into the labour and human rights risks in supply-chain sourcing of 34 Australian companies in June 2013.⁶⁷ The issue of human rights was topical given that the Rana Plaza disaster had taken place shortly before, prompting many boards to rethink their approach to supply chain management.

Company data was collected on public policy disclosure and management controls relative to exposure to labour and human rights risks via geographical location of supply chains. The report found that of the 34 companies investigated, only 48% had a publicly available policy addressing labour and human rights in the supply chain and only one third had anti-child and forced labour policies. According to ACSI, poor management of human rights risks in supply chains and inadequate disclosure levels '...threatens the long-term performance and stability of the companies and poses a real threat to institutional investors such as superannuation funds.'⁶⁸ Since engaging with these companies on the topic, ACSI has recorded some improvements, but companies still require support in improving the management of their offshore supply.

Nevertheless, the Australian financial sector is not uniformly embracing human rights due diligence. A recent benchmarking report by BankTrack⁶⁹ found that banks' overall implementation of the UNGPs remains poor. BankTrack benchmarked 45 of the largest banks globally against a set of 13 criteria, based on the requirements of the UNGPs. It found that performance was disappointing overall, with no 'true leaders'. Of the four Australian banks included in the report, only one was part of the next tier, 'front runners' with two among the 'followers' and one in the 'laggards' group.

Figure 2: Integration of human rights into governance and investment process among 34 asset owners

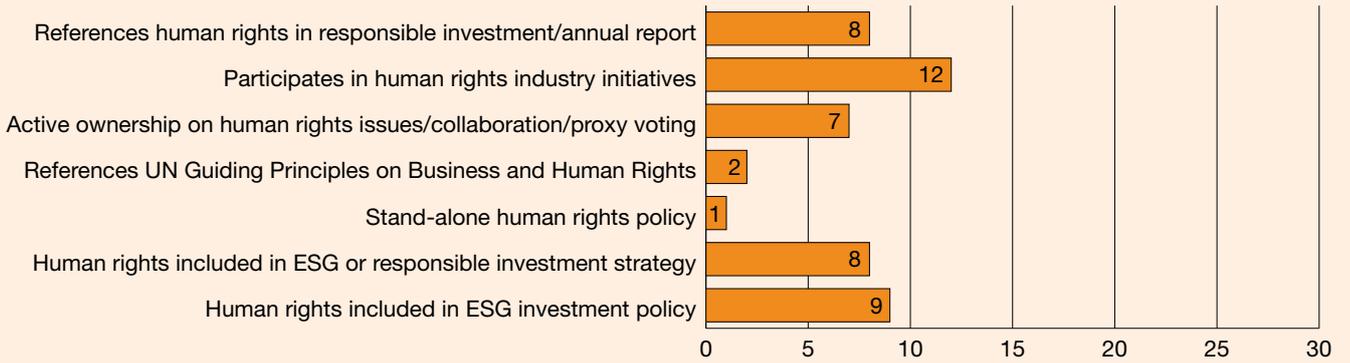


Figure 3: Integration of human rights into governance and investment process among 11 asset managers

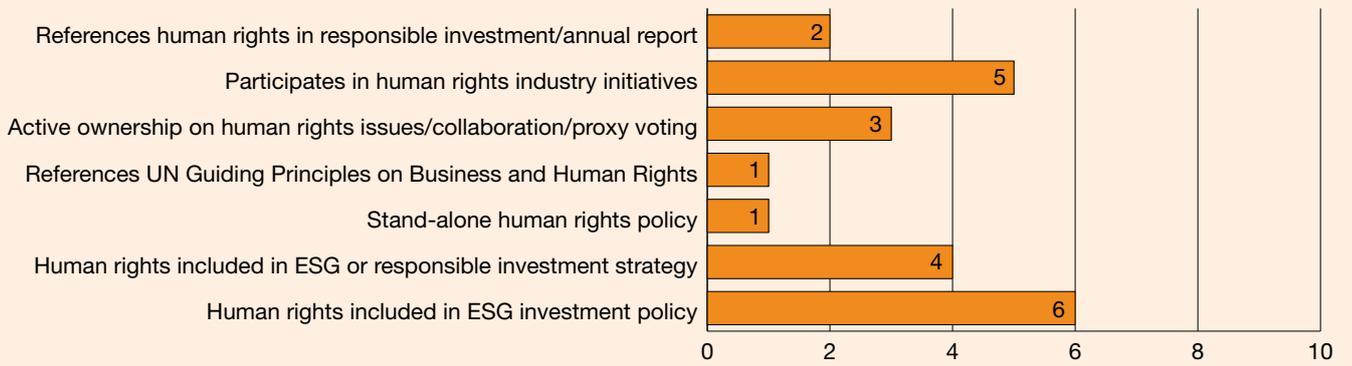
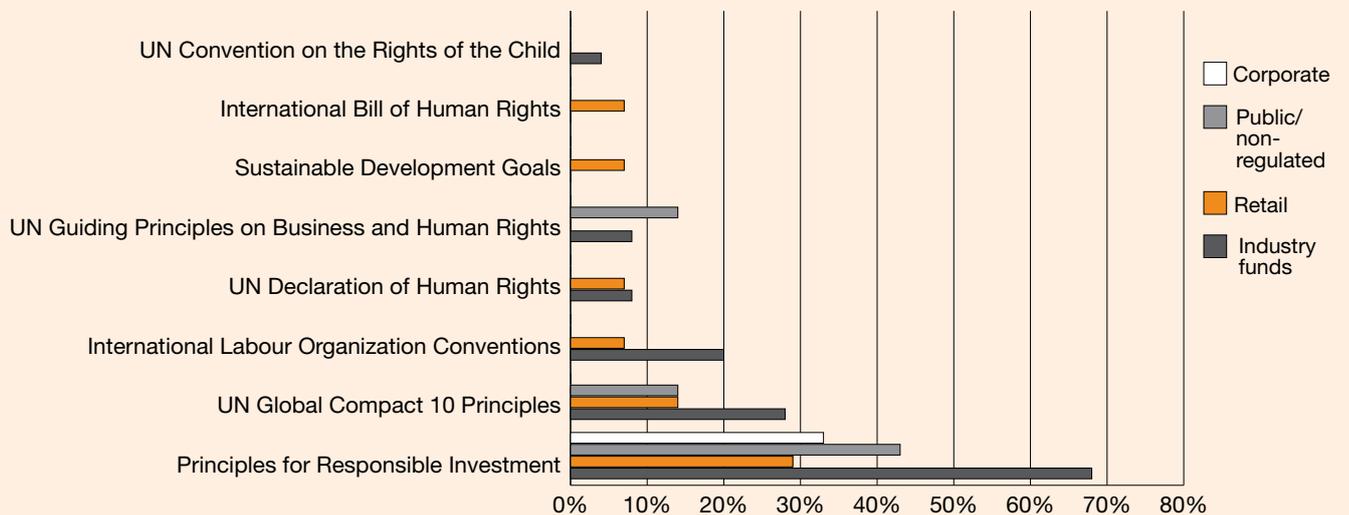


Figure 4: International norms and conventions by fund category



Source: RIAA Superfund Responsible Investment Benchmark Report 2016 and EY Benchmark Analysis

9. Conclusion and action points

On 17 February 2017, the Federal Government announced that it was initiating an inquiry into whether Australia should look to introduce legislation akin to the UK Modern Slavery Act, in recognition of the impact that modern slavery and forced labour has.⁷⁰ On the same day, Geoff Summerhayes, Executive Board Member of the Australian Prudential Regulation Authority, delivered a speech emphasising the responsibility of directors and companies to disclose their exposure to and mitigation of climate risks.⁷¹ ESG, it seems, is not just high on the public agenda – it is being taken seriously by standard setters and regulators alike.

Leaders in the field are adopting behaviours to integrate this into their business management, but for many, the mainstreaming of human rights risks along with other ESG considerations remains a challenge. Below, we propose a number of steps that fiduciaries in Australia may wish to consider to integrate human rights across their investment decisions.

Enhance your understanding of human rights

In-depth understanding on human rights among investors and asset managers is limited and the required ‘whole of business’ human rights sensitivity is difficult to achieve. Investors should be able to evaluate the extent to which businesses they invest in demonstrate their ability to ‘know and show’ their understanding of how they might impact on human rights and what they have in place to avoid or mitigate those impacts. There will likely be a need for investors to develop a better understanding of business and human rights. Measures to address this are very similar to those that could be taken by companies that wish to be considered for investment. Recommendations therefore largely apply to both investors and investees, with the added need for investors to scrutinise potential investees for their human rights management as well. Important first steps might include:

- Carrying out a human rights risk assessment, considering both inherent risk and the residual risk, once existing mitigating policies and practices have been considered. By understanding their human rights risk profile, investors can improve their human rights risk management.



- Adopting a public human rights policy or statement. The first step in aligning a business with the UNGPs is to adopt a formal public commitment to respecting human rights, in line with the UNGPs and the minimum international human rights instruments referred to within them.
- Adjusting existing policies to the company human rights commitment. Once a company has made a public commitment to respecting human rights, it needs to give itself the means to honour it. This might include mapping existing policies to identify any gaps, addressing those gaps and adopting any complementary policies required.

Take practical steps to embed your commitment to human rights



Once an investment fund or business has developed its understanding of human rights and adopted a formal commitment, it is critical to ensure that this commitment is embedded throughout business processes and that these are properly applied. This can be done by:

- Communicating across the business about the nature of the human rights commitment and its requirements of each member of the business.
- Developing guidelines for integrating human rights due diligence in business processes, as well as remedial measures or grievance mechanisms, which for investors might include the exercise of shareholder rights or divestment guidelines and timeframes.
- Including human rights performance indicators in the appointment and assessment of key staff, such as asset managers.
- Adopting processes and guidelines for how any adverse human rights impacts that the investment fund or company is connected to should be dealt with, communicated and remedied.

Monitor, learn and share

While understanding and addressing human rights risks internally is the first step to respecting human rights, demonstrating that this is being done and how the process for doing so is regularly assessed for its effectiveness are equally important. These are likely to include:



- Adopting processes to monitor respect for human rights throughout the business, including in procurement, recruitment and investment. This should include a clear assignment of ultimate responsibility for company human rights commitments at Board or Executive level.
- Designing human rights training for relevant members of staff and ensuring that appropriate levels of knowledge are maintained on recent developments in business and human rights.
- Publishing meaningful and transparent public disclosures on progress against human rights commitments and any challenges encountered.

Respecting human rights should remain largely in the 'pre-competitive' space and collaboration on achieving progress is critical. Given their broad overview of the market and connection to a range of sectors, there is a lot that investors can do to advance knowledge in the market about where major industry risks lie and how the relevant industry deals with them.

In this type of endeavour, collaboration with specialist agencies, NGOs, industry associations, or other stakeholders are encouraged. Initiatives might include holding knowledge sharing forums on salient human rights issues; collaborating on research around financial performance and its link to respecting human rights in the Australian context; or taking part in developing tools, such as checklists, corporate benchmarking ratings and a 'human rights-investment dictionary' for the Australian market.

Despite the current unpredictable geopolitical situation, the momentum of the UNGPs is forging ahead. European governments and public institutions have taken a clear lead applying and introducing legislation to implement the UNGPs, and Australia is following close behind. The proposed National Action Plan on Business and Human Rights, the enquiry into introducing modern slavery legislation and the practical implementation of the UNGPs by some leading Australian financial institutions are all signs of what is likely to come. Perhaps it is particularly in times of volatility and uncertainty that people return to ethics and fundamental moral norms for guidance. If so, business, and those that invest in them will have little choice but to publically and unequivocally embrace the expectation that they will respect human rights, as failing to do so is likely to cost them dearly in social license and, ultimately, their returns to shareholders.



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