



GLOBAL FORUM ON RESPONSIBLE BUSINESS CONDUCT

Expert letters and statements on the application of the OECD Guidelines for Multinational Enterprises and UN Guiding Principles on Business and Human Rights in the context of the financial sector

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This document serves as reference material for the session on Responsible Business Conduct in the Financial Sector of the Global Forum on Responsible Business Conduct taking place in Paris on 26-27 June 2014.

The opinions and views expressed and arguments employed herein are those of the authors and do not necessarily reflect or represent the official views of the OECD or of the governments of its member countries.

Expert letters and statements on the application of the OECD Guidelines for Multinational Enterprises and UN Guiding Principles on Business and Human Rights in the context of the financial sector

Recent research and events have demonstrated a lack of clarity on the application of the OECD Guidelines to the financial sector.

Subsequent discussion within the OECD Working Party on Responsible Business Conduct and United Nations and Office of the High Commissioner for Human Rights have affirmed that the OECD Guidelines for Multinational Enterprises ('the Guidelines') should be applied within the financial sector in the same manner that they are applied by other multinational enterprises.

Under the Guidelines enterprises are encouraged to conduct due diligence to prevent and mitigate a range of adverse impacts. Due diligence processes under the Guidelines and UN Guiding Principles for Business and Human Rights can help financial institutions evaluate the risks of adverse impacts and respond to them appropriately.

This document compiles expert letters and statements for the purpose of providing clarity on the issue of application of the Guidelines in the context of the financial sector.

It contains the following documents:

- A letter from Former UN Secretary-General's Special Representative for Business and Human Rights, Professor Ruggie;
- A letter from the United Nations Office of the High Commissioner for Human Rights; and
- A note by the Chair of the negotiations on the update of the Guidelines, Professor Roel Nieuwenkamp, providing clarity on terminology as it was used at the time of the 2011 negotiations of the Guidelines, in order to serve the discussions on how this terminology applies to the financial sector.



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JOHN G. RUGGIE

Berthold Beitz Professor in Human Rights and International Affairs
Affiliated Professor in International Legal Studies, Harvard Law School

22 October 2013

Mr. Roel Nieuwenkamp
Chair, Working Party for Responsible Business Conduct
Organization for Economic Cooperation and Development
2, rue André-Pascal
75775 Paris CEDEX 16
France

Dear Mr. Nieuwenkamp,

Thank you for your letter of 17 October 2013, requesting my views on a number of issues regarding the UN Guiding Principles on Business and Human Rights (“GPs”) and the OECD Guidelines for Multinational Enterprises (“GLs”). Perhaps I can begin with two overarching points and then proceed to your specific questions.

First, the GPs comprise three pillars: the State duty to protect against human rights abuse by third parties, including business enterprises; the corporate responsibility to respect human rights, which exists independently of States’ abilities and/or willingness to fulfill their own human rights obligations; and access to effective remedy, both judicial and non-judicial, for those who are harmed, where non-judicial may include grievance mechanisms established by or otherwise engaging companies. Thus, under the GPs human rights abuses involving business enterprises that are controlled by the State, or whose acts can otherwise be attributed to the State, may bring into play both Pillar 1 and Pillar 2 provisions.

Second, in terms of Pillar 2 (enterprises’ responsibility to respect human rights), the GPs and GLs are very closely aligned, as you noted in your letter. This was done deliberately, urged by all stakeholder groups including business, in order to achieve maximum convergence and predictability in what had been a highly fragmented field of often conflicting codes and expectations. The GPs and GLs both are very clear on this cardinal point: the responsibility of business enterprises to respect human rights applies to all types of enterprises regardless of their size, sector, operational context, ownership and structure. The means by which a business enterprise meets this responsibility may vary in some respects depending on situational factors, but the principle itself is uniformly applicable.

Now on to your questions:

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1. What is meant by being “directly linked,” both in general and for financial institutions specifically?

The GPs and the GLs both stipulate that the responsibility of business enterprises to respect human rights is not a function of how much influence they have to change a particular situation, but of whether and how they are involved with a human rights harm at issue. Only once such a responsibility is established does the question arise as to what the enterprise can be expected to do in order to address the harm. The GPs and GLs differentiate among three types of “involvement” by business enterprises in human rights harm: they may cause a harm; contribute to a harm; or the harm may be linked to their operations, products or services through one of their business relationships. GP19 (and Commentary) as well as the GLs under the General Policy and Human Rights chapters elaborate on what these provisions mean and imply. You are asking about the third category, which gives rise to a standard of conduct with a reasonableness threshold.

Global supply chains illustrate such links. For instance, there have been frequent fires and building collapses in the Bangladesh garment industry. Say that a building does collapse and workers are hurt or die, and that the factory in question is producing for the global brands. Let us assume for the sake of the argument that the brands did not cause or contribute to the harm. Nevertheless, the harm clearly is linked to their products, and directly so. In brief, under the GPs and GLs the brands are expected to seek ways to prevent or mitigate the risk of such harm continuing or recurring—and, if that proves impossible, to consider ceasing the relationship with the supplier, while taking into account any adverse human rights impacts that doing so might have. If first-tier suppliers, in turn, outsourced part of the production and the harm occurred in one of those facilities, the situation faced by the brands would be more complex but the analogous standard of conduct holds. Needless to say, these provisions of the GPs and GLs are not intended to shift responsibility from the entities causing the harm. They address the separate and distinct responsibility stemming from the harm being linked to the brands’ products through a business relationship. The recently concluded Accord on Fire and Building Safety in Bangladesh, and the Alliance for Bangladesh Worker Safety, are but the latest initiatives by global brands to manage such risks in that particular country.

In the case of financial institutions, the corresponding link is through the financial products and services they provide to operating entities that may cause or contribute to harm. Banks that provide project finance were early movers in addressing such risks by establishing the so-called Equator Principles. Currently there are seventy-eight Equator Principles Financial Institutions in thirty-five countries, covering over seventy percent of international project finance debt in emerging markets. The Equator Principles were recently updated to better align with the GPs, and their provisions now include human rights due diligence. Beyond that market segment, a group of banks that provide a variety of financial services (Barclays, BBVA, Credit Suisse AG, ING Bank N.V., RBS Group, UBS AG, and UniCredit) recently issued a report on what they view the GPs to mean and imply for financial institutions in retail banking, corporate investment banking, and asset management. Again, adequate human rights due diligence features centrally, including for asset management.

As these developments illustrate, financial institutions are no different from any other kind of business enterprise in that human rights harm may be linked to their products or services through a business relationship. How much influence they may have to change the situation is a separate question.

2. To what extent and in what way are minority shareholders covered by this provision?

The GPs and GLs address enterprises' responsibility to respect human rights. Both state that this responsibility applies to all enterprises, irrespective of such factors as ownership or size. Both acknowledge that the scale and complexity through which enterprises meet their responsibility to respect human rights may vary according to such factors. But the fact of an enterprise being a minority shareholder is not dispositive as a basis for establishing what those means should be, nor is it even particularly helpful. This is so for several reasons.

First, by definition the category of minority shareholder applies to anyone who has below fifty percent ownership of a firm's equity capital. Thus, if the category of minority shareholders were not covered by this provision that would cause an extraordinarily large number of business ventures to fall through the cracks, which is decidedly not the intent of the GPs or the GLs.

Second, given the wide dispersion of investors in publicly listed companies, ownership of a relatively small percentage of a company's common stock might confer significant influence over the company to a minority shareholder, such as an investment firm, which could result in its representative getting a seat on the board, its having a significant say in the wording of shareholder resolutions, or otherwise requiring management to pay close attention to its suggestions.

Third, as the previous supply chain and banking examples illustrate, the GPs and the GLs apply to business enterprises that have *zero* equity relationship with their business partners. Few if any of the global brands hold shares in their supplier factories, and each may procure only a fraction of those factories' output. Yet they are expected to conduct risk-based human rights due diligence and to act upon the findings. Much the same is true of companies whose products contain minerals from far-flung sources, even though each is only one of thousands of companies whose products contain minerals from the same sources. Yet they are expected to make a good faith effort to know and show that those minerals do not come from mining activity that funds conflicts, for example, or employs child or forced labor. In project finance, banks do not take equity positions but provide loans, which typically constitute only one among many funding sources for a particular project. In short, if the provisions of the GPs and GLs hold for "zero shareholders" that are but one among many, surely the same principles cover enterprises that are minority shareholders.

Where very small holdings do come into play is in determining what a shareholder is able to do in order to effect change in the policies and practices of the business enterprise that is causing or contributing to harm. But this question has been around for a long time, for all types of investors. The options have always included attempts to engage the enterprise with

the aim of improving its performance, alone or in collaboration with other shareholders; voting proxies; and divesting if the harm is severe and the company is not responsive.

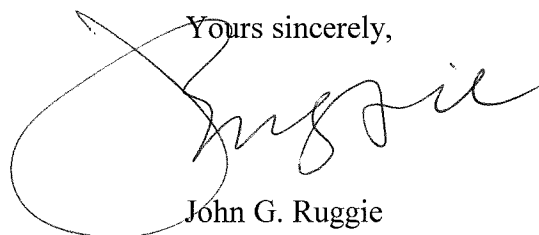
3. To what extent and in what way do you consider investments in sovereign bonds to be covered by this provision?

Under my UN mandate, I conducted nearly fifty international public consultations on five continents, and held numerous private meetings with officials, affected individuals, and experts. Therefore, I feel quite secure that in the matters the GPs address they are robust and enjoy wide consensus (including unprecedented unanimous endorsement by the UN Human Rights Council). But I would be straying too far from the mandate if I offered a view on the question of sovereign bonds, which was not the subject of any of our consultations and, to my knowledge, has not been addressed centrally in corporate responsibility discussions.

In conclusion, allow me to express my appreciation for the opportunity to respond to your questions. I also applaud the OECD for undertaking this deliberative effort. Neither the GPs nor the GLs provide a tool box that can be taken off the shelf and simply plugged in to provide black and white answers for every possible specific instance. Not even international treaties can do that. Nor, for that matter, can national constitutions, statutes, and regulations. What the GPs and GLs do provide is authoritative guidance for more operational rules. The OECD has the additional advantage of the National Contact Point system where independent judgment can be exercised, and ultimately the Investment Committee through which Member States can seek further clarification and refinement. This is how States, for now, have chosen to manage these challenges posed by our living in an increasingly tightly-coupled global economy, so we must try and make the best of it.

I wish you every success in your deliberations. Please let me know if I can be of further assistance.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Ruggie', written over a large, stylized circular flourish.

John G. Ruggie



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REFERENCE: RRDD/DESIB/CM/ff

Geneva, 27 November 2013

Subject: Request from the Chair of the OECD Working Party on Responsible Business Conduct

Dear Mr. Nieuwenkamp,

In response to your letter to the Office of the High Commissioner for Human Rights requesting advice regarding the Guiding Principles on Business and Human Rights and the financial sector, please see attached.

Please do not hesitate to follow up with my office through Ms. Lene Wendland (lwendland@ohchr.org) if further clarification or guidance is needed.

Yours sincerely,

Francesca Marotta,
Officer-in-Charge

Development and Economic and Social Issues Branch
Office of the High Commissioner for Human Rights

Mr. Roel Nieuwenkamp
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Introduction

1. The Office of the United Nations High Commissioner for Human Rights (OHCHR) received a letter dated 17 October 2013 from the Chair of the Working Party on Responsible Business Conduct (WPRBC) of the Organisation for Economic Co-operation and Development (OECD), requesting advice on the following three questions relating to the Guiding Principles on Business and Human Rights¹:

1. What is meant by being “directly linked”, both in general and for financial institutions specifically?
2. To what extent and in what way are minority shareholders covered by this provision?
3. To what extent and in what way do you consider investment in sovereign bonds to be covered by this provision?

2. The following advice is related to the application of the Guiding Principles on Business and Human Rights.² As noted by the Chair of the WPRBC in his request to OHCHR, the OECD Guidelines for Multinational Enterprises are closely aligned with the Guiding Principles. The advice is provided in response to the request from the WPRBC, and does not express an opinion about any specific cases or the acts of any specific institutions or enterprises.

3. The United Nations Working Group on the issue of human rights and transnational corporations and other business enterprises also received an invitation from the WPRBC to provide advice on the above questions, as did the former Special Representative of the United Nations Special Representative, Professor John Ruggie. OHCHR has consulted with the Working Group in the preparation of this advice.

4. This document furthermore builds on, and aligns with, earlier advice related to the financial sector issued by OHCHR on 26 April 2013 in response to a request from SOMO and OECD Watch.³ OHCHR expressed the view that the Guiding Principles apply to minority shareholdings of institutional investors, and that such shareholdings constitute a business relationship for the purposes of the Guiding Principles. The response to SOMO and OECD Watch also elaborated on the issue of “leverage” in the context of minority shareholdings.

¹ The Guiding Principles are contained in the final report of the Special Representative of the UN Secretary-General on the issue of human rights and transnational corporations and other business enterprises to the Human Rights Council, A/HRC/17/31. Available at:

http://www2.ohchr.org/english/bodies/hrcouncil/docs/17session/A.HRC.17.31_en.pdf. The Guiding Principles were unanimously endorsed by the Human Rights Council in Resolution 17/4, available at <http://daccess-dds-ny.un.org/doc/RESOLUTION/GEN/G11/144/71/PDF/G1114471.pdf?OpenElement>

² As the principal United Nations office mandated to promote and protect human rights for all, OHCHR provides expertise, technical assistance and other advice to relevant stakeholders on international human rights standards and the protection of human rights worldwide. See also report by the United Nations Secretary-General: “Contribution of the United Nations system as a whole to the advancement of the business and human rights agenda and the dissemination and implementation of the Guiding Principles on Business and Human Rights”, A/HRC/21/21, paras. 32 – 33 and 96.

³ See OHCHR response to SOMO and OECD Watch, 26 April 2013: <http://www.ohchr.org/Documents/Issues/Business/LetterSOMO.pdf>. See also OHCHR publication “The Corporate Responsibility to Respect Human Rights: An Interpretive Guide” (2012), HR/PUB/12/02.

1. What is meant by being “directly linked”, both in general and for financial institutions specifically?

General considerations

5. The Guiding Principles (GP) stipulate that companies can be involved with adverse human rights impacts “either through their own activities or as a result of their business relationships with other parties”⁴.

6. A distinction is made between situations where a company has caused or contributed to an adverse impact and situations where the company is involved with an adverse impact through its business relationships. GP 13 states that the responsibility to respect human rights requires business enterprises to:

a) avoid causing and contributing to adverse human rights impacts through their own activities, and address such impacts when they occur;

b) 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.

7. The Guiding Principles stipulate that enterprises should have in place policies and systems to ‘know and show’⁵ that they respect human rights. This involves undertaking on-going human rights due diligence to identify, prevent, mitigate and account for how they address their impacts on human rights.⁶ Such due diligence should cover both the impacts that the business may cause or contribute to through its own activities and those that may be directly linked to an enterprise’s operations, products or services through its business relationships.⁷ The Guiding Principles recognize that it may not be possible to conduct due diligence across all entities in an enterprise’s value chain, and that enterprises may thus need to identify general areas where the risk of adverse human rights impact is most significant. If an enterprise is made aware – through its own due diligence or through other means - of an adverse human rights impact that is linked to its operations, products or services through a business relationship, the enterprise has a responsibility to seek to prevent or mitigate the risk that it continues or recurs.⁸ The appropriate action will depend on several factors, including what leverage the enterprise has to change the behaviour of the entity causing the harm. The enterprise may ultimately need to decide whether it can remain in that relationship if no change is taking place.⁹ However, the question of whether the business has leverage to affect change is separate from whether the responsibility exists in the first place.

8. The following advice deals exclusively with situations where business enterprises, including financial institutions, are involved with adverse human rights impacts caused by other entities, for example their clients, (GP 13 (b)), and not with situations where business enterprises themselves cause or contribute to adverse impacts through their own activities (such situations fall instead under GP 13 (a)). In other words, it deals with situations where the adverse human rights impact is *only* linked to

⁴ Ibid note 1, GP 13.

⁵ Ibid note 1, GP 15,

⁶ Ibid note 1. GPs 17 – 21.

⁷ Ibid note 1. GP 17.

⁸ See also OHCHR: The Corporate Responsibility to Respect Human Rights: An Interpretive Guide (2012). HR/PUB/12/02, p. 48.

⁹ Ibid note 1, GP 19.

the operations, products or services of an enterprise through a business relationship, and where the enterprise's activities have *not* caused or contributed to the adverse impact. Financial institutions can cause or contribute to adverse human rights impacts – for example, with respect to their own employees – but as per the questions posed by the Chair of the WPRBC, the focus of this document is on situations where a financial institution provides financial products or services to clients and those products or services are directly linked to adverse human rights impacts through the client.

Direct linkage

9. The term “direct linkage” has given rise to some confusion. Some have interpreted this to require a direct linkage between the enterprise and the human rights harm – i.e. that the enterprise must have some causal relationship to the harm. This is an understandable misinterpretation of the concept, but a misinterpretation nonetheless. Instead, “direct linkage” refers to the linkage between the harm and the enterprise's products, services and operations through *another* enterprise (the business relationship). Causality between the activities of an enterprise and the adverse impact is not a factor in determining the scope of application of GP 13 (b).

10. It is also important to note that the provision in GP 13 (b) that the impact must be “directly linked” to the operations, products or services of an enterprise through a business relationship is not intended to create two categories of links – one “direct” and the other “indirect” – wherein the former would fall inside the scope of the Guiding Principles while the latter would fall outside. Under GP 13 (b), there is either a (direct) link between the products, services or operations of a business enterprise and an adverse impact through a business relationship, or there is no link. If there is no link, the Guiding Principles would not apply and the business enterprise would have no responsibility under the Guiding Principles to take any action with respect to that impact.

11. OHCHR's Interpretive Guide provides an example of a situation where an adverse impact is directly linked to a company's products, services or operations through a business relationship: “Embroidery on a retail company's clothing products being subcontracted by the supplier to child labourers in homes, counter to contractual obligations”.¹⁰ Here, the retail company has not caused or contributed to the impact; on the contrary, it has explicitly prohibited the conduct through its supplier contract. It does not have a direct supplier relationship with the supplier's sub-contractors. However, there is still a direct link between the products of the business enterprise (i.e. clothing) and the adverse impact on the rights of the child labourers who were stitching the embroidery on the clothing through the business relationship that the enterprise has with its supplier. Thus, having been made aware of the situation, the company has a responsibility to seek to prevent or mitigate the risk from continuing or recurring, even if it has not contributed to the impact.

This example and the following demonstrate that the application of GP 13(b) **may include relationships beyond the first tier (or any prescribed number of tiers) in a value chain.**¹¹ A familiar example in the OECD context is the issue of conflict minerals. OECD's Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas¹²

¹⁰ See: OHCHR, “The Corporate Responsibility to Respect Human Rights: an Interpretive Guide”, 2012. HR/PUB/12/02. Page 17. For the purposes of this example, it is assumed here that the retail company has not contributed to the impact by, for example, setting its prices so low that the supplier could not reasonably perform the work using adult, regularly employed labour.

¹¹ See OHCHR, “The Corporate Responsibility to Respect Human Rights: An Interpretive Guide”, *ibid* note 3, page 5.

¹² <http://www.oecd.org/corporate/mne/mining.htm>

is based on the same concept of direct linkage. The Due Diligence Guidance recognises that where a computer manufacturer finds that its products contain conflict minerals, there would be a direct link between the manufacturer's products and the adverse human rights impacts resulting from the mining of conflict minerals, even if there are many layers of suppliers and middlemen between the company and the source of the minerals.

12. It should be noted that Guiding Principle 13 (b) makes clear that while the corporate responsibility to respect extends to one business enterprise's relationship with another business enterprise, it does not intend to shift the burden of responsibility for the impact from the business enterprise causing the impact. Different responses are required from each business partner. The enterprise that is causing the impact has its own responsibility to respect human rights under GP 13(a) – i.e. the responsibility to avoid causing further impacts and to address the impacts that have occurred. The business enterprise whose products or services are only directly linked to the harm through its business relationship, maintains its own, differentiated responsibility – which is to *seek to prevent or mitigate those impacts*, for example through using its leverage in the business relationship. The responsibility is calibrated to the relationship to the harm and is not simply replicated for both business partners without regard to their respective roles.

13. The provision in GP 13 (b) that an impact must be *directly linked* to the products, services or operations of a business enterprise by a business relationship imposes reasonable limits or boundaries on an enterprise's responsibility to respect, thus *excluding* situations where there is not a direct link between the activities of the business enterprise and the harm that is occurring. For example, if a business enterprise is sourcing clothes from a supplier that is also producing handbags for another business enterprise on a separate production line, there is not a direct link between the adverse impacts arising from the production of handbags and the products of the enterprise (i.e. clothes). Similarly, simply operating in a sector where other, unrelated business enterprises may be causing or contributing to adverse human rights impacts would not meet the test of a direct link with the enterprise's products, operations or services through a business relationship. From the financial sector, an example of a situation that would be excluded from the scope of GP 13 (b) would be where a bank provides project finance to a company for a specific project, and that company is involved in adverse human rights impacts in activities unrelated to the project financed by the bank.

14. It bears repeating, however, that it is incumbent on an enterprise to conduct ongoing human rights due diligence to identify potential or actual impacts on human rights with which it may be involved as a result of its business relationships. In the example above, if a business enterprise is made aware of human rights abuses by one of its suppliers on a separate production line, it should be able to demonstrate that it has carried out due diligence to satisfy that no such abuses are occurring on the production lines producing its products. A business that is operating in a high-risk industry where information is brought to its attention that industry peers are causing or contributing to adverse human rights impacts should be able to demonstrate that that it has carried out due diligence commensurate with the risk level and that it is not involved with adverse impacts. In the example from the financial sector, the bank should similarly be able to both 'know and show' that no such adverse impacts are occurring in relation to the project which it has financed. To do so, it must be able to demonstrate that it has conducted adequate human rights due diligence and has sought to prevent or mitigate any identified human rights risks in connection with the specific project.

Application of the term "directly linked" to financial institutions

15. The financial sector is covered by the Guiding Principles in the same ways as all other sectors. As noted above, financial institutions can cause adverse human rights impacts. They can also contribute to adverse impacts through their clients and other business relationships. These situations would be covered by GP 13 (a). As far as GP 13(b) situations are concerned, a direct link between a financial institution's products, services or operations and an adverse human rights impact can arise through its business relationships with investee companies, project partners, clients, and other entities. The term "business relationship" is to be read widely and involves a financial institution's relationship with all of these types of entities.¹³

16. There is already a recognition in the sector itself that financial institutions may be involved with adverse human rights impacts through their business relationships with their clients and investments, as evidenced by initiatives such as the Equator Principles (for project finance),¹⁴ industry led efforts such as the 'Thun group' of banks, which recently released a discussion paper on the implications for banks of GPs 16-21 and the work initiated by UNEP Finance Initiative on the application of the Guiding Principles to the banking sector.¹⁵ These initiatives are evidence that financial sector institutions are already incorporating into their business operations the concept that their responsibility to respect human rights extends to their business relationships with their clients and investments. Many banks also conduct due diligence on so-called politically exposed persons before entering into a client relationship, precisely because it is considered that by providing financial services to such persons, the bank may risk becoming involved with unethical behaviour.

17. At the same time, a survey report commissioned by the Netherlands in support of the Proactive Agenda of the OECD Working Party on Responsible Business Conduct¹⁶ reveals that there may be some misconceptions among financial institutions about the meaning of the Guiding Principles for companies in the sector:

"A number of [financial institutions] interviewed consider that they are **indirectly** linked to human rights issues through the provision of financial services to their clients"

and

"[F]or example, [a financial institution] which (co)finances a company for the construction of a mine typically views its linkage to the potential adverse E&S [environmental and social] impacts related to building the mine as **indirect**"¹⁷. (emphasis added)

18. It appears that the difference in terminology between the financial sector and the Guiding Principles is the source of the misconception. Some financial institutions seem to be distinguishing between impacts which they cause directly and impacts which their clients cause – referring to the later as "indirect impacts". The terminology of "indirect impacts" is not supported by the language of the Guiding Principles. As stated above, there is either a direct link between the adverse impact and

¹³ See OHCHR Interpretive Guide, and OHCHR's letter to SOMO of 26 April 2013:

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

¹⁴ See Equator Principles: <http://www.equator-principles.com/>

¹⁵ See Statement by the Thun Group of Banks, <http://www.business-humanrights.org/media/documents/thun-group-of-banks-statement-guiding-principles-19-oct-2011.pdf> and Thun Group of Banks discussion paper: <http://www.business-humanrights.org/media/documents/thun-group-discussion-paper-final-2-oct-2013.pdf>

¹⁶ Environmental and Social Due Diligence Risk Due Diligence in the Financial Sector – Current Approaches and Practices, Sustainable Finance Advisory, May 2013.

¹⁷ Ibid, page 47.

the products or services a financial institution provides to clients or investee companies or there is no link – there is no such concepts as “indirect linkage” or “indirect impacts” in the Guiding Principles.

19. In the example given in the quote from the report above of providing financing to a mine, depending on the specific context, the financing could either *contribute* to a specific impact (as per GP 13(a)) (such as if financing is provided for a project that will result in widespread displacement of local communities, without safeguards in place), or the impact could be *directly linked* (as per GP 13(b)) to the products and services of the financial institution (such as where risks are mitigated and safeguards are in place, but an adverse impact nevertheless occurs in violation of agreed standards).

2. To what extent and in what way are minority shareholders covered by this provision?

20. OHCHR’s response to SOMO and OECD Watch addressed the question of whether minority shareholders are covered by the Guiding Principles and found that the Guiding Principles apply to investors holding minority shareholdings. The Guiding Principles specifically state that the responsibility to respect human rights applies to all business enterprises, *regardless of their size, sector, operational context, ownership and structure* (Guiding Principle 14). Excluding all minority shareholders would have the effect of excluding any shareholder whose ownership share is less than 50 per cent, which would be counter to both the letter and spirit of the Guiding Principles. As stated in OHCHR’s earlier advice on the subject,¹⁸ the size of an investor’s share is not in itself a factor in determining whether the Guiding Principles apply. Rather, it can be a factor in considering the means through which a business enterprise meets its responsibility to respect human rights, including the leverage it can exercise in its business relationships.¹⁹

21. The specific question here is to what extent minority shareholders can be said to be covered by the provision of ‘directly linked’.

22. As noted above, the ‘test’ for application of the Guiding Principle 13 (b) is whether there is a direct link between the operations, products or services of the financial institution and the human rights impact through a business relationship.

23. In the context of a minority shareholder, there is a business relationship – through ownership – between the investor and the investee company. The relative size or percentage of a share an institutional investor holds in a company is *not* a factor in determining whether there is a business relationship for the purposes of Guiding Principle 13 (b).²⁰

24. Where a financial institution owns shares in a company, it is typically doing so for the purposes of deriving a return on the investment (e.g. from selling its shares at a higher price or from earning dividends) and its ability to do so derives from activities of the investee company. In the investee is involved with an adverse human rights impact there is a direct link – through ownership – between the operations of the investor and negative human rights harms that arise from the activities of the investee company. By way of example, if an investor buys a 1% share in a construction company and the company purchases land and displaces local communities without adequate compensation or otherwise not in line with relevant international standards, the investor will be involved with an adverse human rights impact through its equity stake. The investor is not itself responsible for the

¹⁸ See OHCHR Interpretive Guide, and letter to SOMO of 26 April 2013:

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

¹⁹ See letter to SOMO of 26 April 2013: <http://www.ohchr.org/Documents/Issues/Business/LetterSOMO.pdf>.

²⁰ Ibid.

impact occurring, but there is a direct link between the operations of the investor through its investment in the company (however small) and the human rights harm caused by the investee company.

25. In this situation, the minority shareholder has the responsibility under the Guiding Principles (see GPs 13 and 19) to seek to prevent or mitigate the impact from continuing or recurring. For example, the minority shareholder may consider raising the concern with other engaged investors, raising it with the company's investor relations team, or checking if any shareholder resolutions have been raised or introducing a resolution itself.

26. Investors may hold shares in a very large number of different entities. The Guiding Principles recognize that where an enterprise has a large number of entities in its value chain, it may be unreasonably difficult to conduct due diligence for adverse human rights impacts across them all; this applies to investors with a large number of investments as well.²¹ Investors should thus identify the general areas where human rights risks are most significant, for example potential or existing investments in particular industry sectors, countries, or operating contexts. As stated in the commentary to GP 17, such processes could be "included within broader risk management systems, provided that it goes beyond simply identifying and managing material risks to the company [investor or investee company] itself, to include risks to rights-holders." This approach is relevant both at the screening stage when investors are considering where to focus their efforts in screening investments as well as once investments are made in focusing monitoring and engagement activities on investments that may pose the highest risk to human rights.

27. If human rights risks are identified in connection with a potential investee company at the screening stage, it is appropriate for investors to consider whether to proceed with the investment. If such risks are identified only once the investment is already made, the question is whether the investor has leverage to effect the desired change in the practices of the investee company. The Guiding Principles recognize that the situation in such cases can be complex. There are specific factors that investors will need to consider in determining the appropriate action, including evaluating the extent to which it has leverage, whether it can increase its leverage, how crucial the relationship is to the investor, the severity of the abuse, and whether terminating the relationship with the entity itself would have adverse human rights consequences.

28. It is worth noting that leverage is not a mathematical calculation that automatically equates to the percentage of ownership but instead can be created or increased using a range of contractual and non-contractual techniques, such as acting together with other minority investors to increase their leverage to put the issue on the agenda of the investee company. OHCHR's Interpretive Guide on the corporate responsibility to respect human rights as well as the response to SOMO and OECD Watch further elaborates on this issue.²² Finally, as discussed above, it is worth repeating that the question of whether an investor has leverage to affect change is separate from the question of whether the responsibility exists in the first place.

²¹ Ibid, note 1, GP 17, commentary.

²² See: OHCHR, "The Corporate Responsibility to Respect Human Rights: an Interpretive Guide, ibid note 3, pages 46 - 52. See also OHCHR's letter to SOMO of 26 April 2013: <http://www.ohchr.org/Documents/Issues/Business/LetterSOMO.pdf>.

3. To what extent and in what way do you consider investment in sovereign bonds to be covered by this provision?

29. As Professor Ruggie states in his response to the OECD dated 22 October, the question of sovereign bonds was not specifically addressed during the mandate of the former SRSG and the development of the Guiding Principles. However, this does not mean that this type of investments is exempt from the scope of application of the Guiding Principles.

30. The commentary to GP13 stipulates that the term “business relationships” is intended to be understood widely, and would include relationships with other entities that are not business enterprises: “business relationships’ are understood to include relationship with business partners, entities in its value chain, and any other non-State or *State entity* directly linked to its business operations, products or services” (emphasis added). While a sovereign state issuing a bond may not fall into the traditional understanding of an entity in a value chain, it would be covered under the provision of “any other ...State entity”. Investing in sovereign bonds may therefore be considered a value chain relationship for which the Guiding Principles provide guidance as to the expected standard of conduct.

31. Linkage between the activities of an owner of a sovereign bond and an adverse human rights impact in the State in question may arise, for example if the state issuing the bond is engaged in systematic and deliberate human rights abuses.

32. Given that the scope of activities of a State is very broad, issues of practicality will need to be considered. For example, it will not be possible to do human rights due diligence on every activity or policy of a State. Instead, investors in sovereign bonds should seek to understand the overall human rights situation in a State, and whether the State is responsible for systematic or grave and deliberate human rights violations.

33. An investor holding a sovereign bond whose human rights due diligence has identified a link to adverse human rights impacts through its investment in sovereign bonds is unlikely to have any meaningful leverage over the State in question nor may it be appropriate for an investor to seek to increase or exercise its leverage. In such situations the Guiding Principles provides that the enterprise (here the investor) should consider whether it should stay in the relationship, taking into account credible assessments of potential adverse human rights impacts of ending the relationship.²³ The severity of the human rights harm involved is an important factor in this context. The Guiding Principles define severe human rights impact with reference to its scale, scope and irremediable character.²⁴ This means that its gravity and the number of individuals that are or will be affected will both be relevant considerations.²⁵

34. Some institutional investors and asset managers already operate “exclusion lists” (and sometimes norm-based exclusion lists) for sovereign bonds. Such exclusion lists are developed based on a form of due diligence—screening of the human rights risk profile of the State—and carry at least

²³ Ibid note 1, GP 19.

²⁴ Ibid note 1, GP 19.

²⁵ Ibid note 3, page 8.

an implicit recognition that investment in the sovereign debt of a State that systematically abuses human rights entails a risk of involvement with human rights abuses.²⁶

35. While the issue of sovereign bonds is one that would benefit from further exploration and concrete guidance on practical actions and approaches to be taken by investors, similar to the kinds of guidance being considered for other types of financial services and products that each pose specificities and challenges, the corporate responsibility to respect human rights applies to all impacts that may be directly linked to financial institutions' operations, products or services through a business relationship with state entities, just as the responsibility to respect applies to business relationships with non-state entities.

²⁶ It may also be worth noting that some research points to an increasing recognition among investors that responsibilities extend beyond equity investments. See for example <http://www.eiris.org/blog/pakistan-china-and-india-bottom-of-the-pile-on-sustainability/#more-137>.

NOTE BY THE CHAIR OF THE NEGOTIATIONS ON THE 2011 REVISION OF THE GUIDELINES, REGARDING THE TERMINOLOGY ON ‘DIRECTLY LINKED’

As the Chair of the negotiations on the 2011 revision of the OECD Guidelines for Multinational Enterprises (The Guidelines), I was closely involved with the integration of the terminology on ‘directly linked’ in the Guidelines. In this Note of the Chair, I would like to explain my views on what was being meant during the negotiations with this terminology, in order to serve the discussions on how this terminology applies to the financial sector:¹

(Enterprises should) Seek to prevent or mitigate an adverse impact where they have not contributed to that impact, when the impact is nevertheless directly linked to their operations, products or services by a business relationship.²

During these 2011 negotiations on the revision of the Guidelines, we continuously used the same/equivalent language and examples regarding the terminology on ‘directly linked’ as those that were used in the context of the UN Guiding Principles on Business and Human Rights for implementing the UN “Protect, Respect and Remedy” Framework (UNGPs). We did so deliberately because of the alignment of the Guidelines and the UNGPs, which was the result from very intensive collaboration between the OECD and the UN. All stakeholders and most delegations insisted on staying as close to the UNGPs as possible.

Causality is not a factor when products, services or operations are directly linked to adverse impacts

Causality is a significant feature in determining whether a company is causing or contributing to adverse impacts through their own activities. However, it has been stressed multiple times during the 2011 negotiations on the revisions of the Guidelines that causality is not a factor in determining whether a company’s products, services or operations are ‘directly linked’ to an adverse impact through a business relationship. Hence, in the case that there is causality between the company’s activities, products or services and an adverse impact, the company is either causing or contributing to the adverse impact.

(Lack of) leverage does not affect the responsibility to carry-out due diligence and/or to mitigate adverse impacts

Secondly, it was recognised during the 2011 negotiations that companies’ products, services or operations can be directly linked to *adverse impacts*. It is this direct link to the adverse impact that determines the company’s responsibility to carry out due diligence and/or to mitigate adverse impacts. The amount of leverage of a company does not affect this responsibility itself, but it does influence the nature and extent of the due diligence.

¹ Currently, I am the chair of the Working Party on Responsible Business Conduct (WPRBC), but the expressions in this Note reflect my wording and views at the time that the terminology on ‘directly linked’ found its way into the Guidelines. Hence, it was in the capacity of being the Chairman of the 2011 negotiations on the Guidelines.

² The Guidelines Chapter II, paragraph 12. In the remainder of this Note I will refer to ‘the terminology on ‘directly linked’.

Risk-based due diligence not limited to first tier business relationships

During the 2011 negotiations, we continuously sent out the message that the responsibility to carry out risk-based due diligence is not limited to first tier business relationships. There is no quantitative limit regarding this.

During the negotiations, I have drawn an example from the OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas. Imagine a computer brand using products that contain conflict minerals. Even though there are many tiers between the end product and the conflict minerals, there is nonetheless a direct link between the computer brand's product and the adverse impact. Companies should carry out risk-based due diligence along their entire supply chain.

The nature and extent of this due diligence depends amongst others on the severity and probability of adverse impacts. Companies should use their leverage to prevent or mitigate adverse impacts, but it was recognised during the negotiations that this leverage might be very small.

No 'indirect linkage'

I would like to stress that the term 'directly' was included in the text in order to ensure that extremely loosely connected associations would not be covered by the due diligence provisions. It was never intended to suggest the existence of an 'indirect linkage'. A company's operations, products or services are either 'directly linked' to an adverse impact through a business relationship – or not at all linked as far as the guidelines are concerned.

In this context, an example within the textiles and garments industry was used. One can easily imagine a shoe brand sourcing its shoes from a company that also produces t-shirts (for another business enterprise) in one of its other factories. Within the production line of the shoes, the shoe brand's products are directly linked to any adverse impact arising also beyond the first tier business relationships. However, the t-shirts produced by the same company (as in the supply chain of the shoe brand) concern a separate line of production as they are manufactured in a different factory, quite possibly even in a different country. In that case, there is no direct link between adverse impacts arising from the production of the t-shirts and the production of the shoe brand's products. The shoe brand's products are not directly linked to adverse impacts arising in the production of t-shirts.³ This view was accepted during the negotiations.

Application to the financial sector

During the 2011 negotiations on the revisions of the Guidelines, we did not have enough time to explore the application and implications of the terminology on 'directly linked' to the products, services and operations of the financial sector. Due to these time constraints, no specific examples in this sector were discussed. I acknowledge the difficulties associated with the search for clarity on how this terminology relates to the financial sector.

³ Therefore, with respect to the factory's t-shirt production line, the shoe brand does not have to carry out the due diligence provisions as set out in paragraphs 10, 11 and 12 of Chapter II of the Guidelines. However, the Guidelines Chapter II, paragraph 13 would still apply: "Enterprises should (...) in addition to addressing adverse impacts in relation to matters covered by the Guidelines, encourage, where practicable, business partners, including suppliers and sub-contractors, to apply principles of responsible business conduct compatible with the Guidelines".

Nonetheless, it was reconfirmed that there was a crystal-clear understanding amongst all adherents and stakeholders that the financial sector *is* covered by these provisions, just like any other sector is covered.⁴ The multi-stakeholder advisory group, which included many financial institutions, stressed that there is an urgent need to find practical guidance on the ‘how’ to integrate these provisions of the Guidelines in the work of Financial Institutions, not on the ‘if’.

⁴ At the Corporate Responsibility Roundtable in 2007 it was already confirmed that the Guidelines are “Addressed *inter alia* to multinational enterprises operating in the financial sector”.

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