Finance &
Human Rights

Labelling for financial products

How to integrate human rights

Executive Summary

ESG labels have been around for 20 years[01] with the aim of helping to identify sustainable or ESG conform financial products. They are often led by the private sector, but governments have now also started creating national labels. Currently, the European Union (EU) envisions the creation of a sustainable label for financial products. The proposed EU Taxonomy, which will guide the future EU Ecolabel for financial products, requires compliance with minimum social safeguards, including the UN Guiding Principles on Business and Human Rights (UNGPs).[02]

We advocate that respecting human rights is a core element of any economic activity framed as responsible and/or sustainable, including by labelling frameworks. While accurate indicators for measuring the actual impact of business on human rights are still under development, assessment of businesses adhesion to the UNGPs is possible.

Therefore, our proposal for a framework to assess respect for human rights lies on ensuring adhesion to the UNGPs. We believe that though this is a good way to start, the business and human rights community should continue its efforts to develop formats to measure impact, so that we can gradually integrate them within assessment frameworks, including those of financial labels.

In line with this approach, we propose the following criteria for funds that could be integrated in labels schemes to assess respect for human rights (details on page 6-9):

01 EFAMA (2017): EFAMA opinion on ESG fund ratings and labels, p. 1
02 EU Taxonomy - Proposal for a Regulation on the establishment of a framework to facilitate sustainable investment (2019), article 13

Criterion 1

The applicant investment fund has a public commitment to respect human rights and to conduct human rights due diligence

Criterion 2

The applicant investment fund clearly communicates its expectations regarding human rights due diligence towards investee companies

Criterion 3

The applicant investment fund adopts an exclusion list as no-go criteria, listing the business sectors in which the fund is not investing

Criterion 4

The applicant investment fund assesses whether the investee companies have policies and procedures in line with the UNGPs, and a minimum percentage of the fund assets relates to investee companies with a good human rights performance

Criterion 5

The applicant investment fund actively engages with companies to foster improvement on human rights performance

Criterion 6

The applicant investment fund has a whistle-blower system in place through which human rights violations can be reported and addressed in line with the UNGPs

Criterion 7

The applicant investment fund reports annually on its process to ensure alignment to the label criteria

In the context of the Sustainable Development Goals (SGDs), we highlight the importance of labels to avoid using alignment to specific SDGs as the sole criteria regarding human rights performance. We advocate, though, that labels should encourage investment funds and investee companies to assess how their implementation of the UNGPs can contribute to the SDGs.

Through this paper, we aim to contribute to the debate around the integration of human rights in investment practices, by providing the financial community with practical guidance.

Why a label?

The UNGPs, unanimously endorsed by the UN Human Rights Council in 2011, entailed "the first global standard for preventing and addressing the risk of adverse impacts on human rights linked to business activity".[03]

Not long ago, a statement calling for investors to enhance environmental, social and governance (ESG) risk management, including human rights risks, was signed by a group of institutional investors representing USD 1.9 trillion in assets under management, and sent to EU policymakers.[04] Through this statement, they reaffirmed investors' ability to help mitigate environmental and social challenges and to support achieving the vision established in the 2030 Agenda for Sustainable Development and in the 17 Sustainable Development Goals (SDGs).[05]

The 2030 Agenda for Sustainable Development was adopted in 2015, providing a path for action on 17 Sustainable Development Goals (SDGs), which have economic, social and environmental dimensions – a call for action not only for States, but also for the private sector and civil society.

In this regard, the Agenda 2030 states a clear mandate for businesses "to apply their creativity and innovation to solving sustainable development challenges", while "protecting labour rights and environmental and health standards" in line with international human rights and labour standards.

The SDGs cover a wide range of pressing issues that have human rights at the core, including reducing poverty, inequality, climate, environmental degradation and fostering prosperity, peace and justice.

Source: The 2030 Agenda for Sustainable Development

The financial sector has a huge leverage to push further the realisation of these goals. There is an annual SDG financing gap of USD 2 to 3 trillion that the financial sector must help bridge.[06]
Thus, investors must place their money responsibly in sustainable financial products.

There has been a fast growth in responsible or sustainable investing, most notably in financial products that integrate ESG considerations.[07]
These ESG products include environmental, social, and governance considerations and are increasingly demanded. Thus, the ESG trend has made its way to mainstream finance. However, how can investors distinguish sustainable or ESG conform financial products from those that only claim to be so? Labels have been regarded as a useful tool to help investors make informed and transparent decisions and promote sustainability among financial products.

ESG labels have been around for 20 years[08]
and look at the processes and methodology of ESG integration in financial products such as funds. They provide investors with a reliable, trusted choice of sustainable financial products without having to conduct a detailed research themselves. If a financial product wants to stand out as being sustainable, it can apply to obtain the sustainable label- provided it fulfils the label's criteria – which should facilitate its public recognition as a sustainable financial product.

03 UN Office of the United Nations High Commissioner for Human Rights: Business and human rights
04 Investor Alliance for Human Rights (2019): Making Finance Work for People and Planet
05 ibid
06 UN Global Compact (2019, September 27): United Nations Global Compact launches network of Chief Financial Officers to direct funds towards Sustainable Development Goals [Press release]
07 According to the United Nations Environmental Programme (UNEP) Inquiry and the United Nations Principles for Responsible Investment (UN PRI), ESG is broadly defined as follows: "(i) Environmental (E) issues relate to the quality and functioning of the natural environment and natural systems; (ii) Social (S) issues relate to the rights, well-being and interests of people and communities; and (iii) Governance (G) issues relate to the governance of companies and other investee entities."
EU Commission Staff Working Document (2018): Impact Assessment (SWD(2018) 264 final), p. 11
08 EFAMA (2017): EFAMA opinion on ESG fund ratings and labels, p. 1

EU’s efforts to boost the sustainable finance agenda: The EU Taxonomy and EU Ecolabel

Labels are often led by the private sector, but governments have now also started creating national labels. Now, the EU envisions the creation of a sustainable label for financial products. The EU has committed to implementing the 17 Sustainable Development Goals (SDGs) in its internal and external policies in order to achieve a sustainable economy.[09] For that, the European Commission has issued the EU Sustainable Finance Action Plan[10] in 2018 to boost the economic leverage the financial industry has to reduce, or even close, existing investment gaps to reach the SDGs goals.

The action plan has as its core directing private capital flows towards sustainable financial products in order to increase sustainable financing at the EU level. It creates a financial policy framework that integrates environmental, social and governance considerations. The action plan envisions, inter alia, an EU Taxonomy and EU sustainability standards and label[11] to “help investors and other financial actors contribute to the transition to a sustainable economy and engage in a dialogue with companies.” [12]

Taxonomies are a common classification tool in the financial industry, and, the EU Taxonomy aims at providing a harmonised language of what financial products can be considered as “environmentally sustainable”.

And how does the EU Ecolabel relate to the EU Taxonomy? The EU Taxonomy will be used as guidance in the development of the EU Ecolabel, which is expected to provide investors with a more transparent and, thus, easier and better-informed investment selection.

The results from the EU Ecolabel for Financial Products Questionnaire by stakeholders include:

- 90% believe that social criteria should be included in the EU Ecolabel
- The social aspects seen as most relevant to stakeholders are human rights (79%), labour rights (74%) and health and safety (57%), which in essence are all human rights.
- 90% elected human rights violations as the most important exclusions based on social and ethical criteria

Sources: Joint Research Centre (2019): EU Ecolabel criteria for Financial Products – Preliminary report, first draft; Joint Research Center (2019): Development of EU Ecolabel criteria for Retail Financial Products – (Draft) Technical Report v1.0

09 EU Commission: EU approach to sustainable development
10 EU Commission (2018): Action Plan: Financing Sustainable Growth
11 ibid
12 UNEP Finance Initiative (2019): European Commission’s Technical Expert Group on Sustainable Finance launches reports, including on an EU Taxonomy, to help drive the transition towards a sustainable economy [Press release]

For an economic activity to be EU Taxonomy-aligned, it needs to contribute substantially to at least one of the six environmental criteria, i.e. climate change mitigation, climate change adaptation, sustainable use and protection of water and marine resources, transition to a circular economy, pollution prevention and control, and protection and restoration of biodiversity and ecosystems, and in addition do no significant harm to the other five. Furthermore, the activity must comply with minimum social safeguards.[13]

These minimum social safeguards are envisaged in Article 13 of the EU Taxonomy proposed regulation. The economic activity needs to be carried out in line with the OECD Guidelines for Multinational Enterprises and the UNGPs, including the principles and rights set out in the International Labour Organisation's declaration on Fundamental Rights and Principles at Work and the International Bill of Human Rights. The final report issued by the Technical Expert Group on Sustainable Finance in March 2020, provides final recommendations to the European Commission with respect to the overarching design of the Taxonomy, including guidance on how those using the Taxonomy can develop Taxonomy disclosures.[14]

The EU Taxonomy sets performance thresholds. In the context of human rights, alignment with the UNGPs and the OECD Guidelines requires that the undertaking conducts a human rights due diligence, i.e. the process to identify, prevent, mitigate and account for how it addresses its actual and potential impacts on human rights.

Since the EU Taxonomy might certainly be used by EU Member States working on criteria of national labels for investment products, national labels will also have to move towards a classification system that explicitly includes human rights considerations.

13 EU Taxonomy - Proposal for a Regulation on the establishment of a framework to facilitate sustainable investment (2019), article 3
14 EU Technical Expert Group on Sustainable Finance (2020): Taxonomy: Final report of the Technical Expert Group on Sustainable Finance

National efforts to boost the sustainable finance agenda: Existing national labels

There are different voluntary national labels available on the European market.[15] For instance, the LuxFLAG Environment (Luxembourg), LuxFLAG Climate Finance (Luxembourg) and Greenfin Label (France) focus on green factors by excluding sectors that are detrimental to the environment, using varied thresholds and technical policies.

The SRI Label (France), FNG-Siegel (Germany, Austria and Switzerland), LuxFLAG ESG (Luxembourg), Towards Sustainability (Belgium), Umweltzeichen (Austria) and Nordic Swan Ecolabel (Nordic countries) all use ESG considerations in their labelling criteria. The minimum coverage for ESG analysis of portfolio assets varies significantly.

But how are these labels addressing human rights? So far, labels have integrated human rights matters mainly by requiring the exclusion of companies conducting certain activities and practices. Towards Sustainability, for instance, integrates human rights aspects within its section "excluded activities and practices", stating that financial products should not finance companies involved in violations of the 10 principles of the UN Global Compact, nor those "that pose an unacceptable risk to contribute to or be responsible for serious or systematic human rights violations".[16]

Having human rights as one of the core elements in exclusion criteria is particularly important and therefore a very welcome practice. However, additional clear requirements should be considered and, in this context, we observe the need for further guidance on how human rights criteria can be incorporated into labels.

15 For an overview of European sustainable finance labels, see Novethic report (2020).
16 Belgian Financial Sector Federation (2019): A quality standard for sustainable and socially responsible financial products, p. 21

What’s next? The need for a stronger focus on human rights

We advocate that respecting human rights is a core element of any economic activity framed as responsible and/or sustainable. Additionally, we endorse the EU Taxonomy’s requirement that minimum safeguards should be in place, in line with the UNGPs, the OECD Guidelines for Multinational Enterprises, the eight ILO Core Labour Conventions and the International Bill of Human Rights.

First, human rights are to be understood in a holistic way, i.e. all human rights such as labour rights, health and safety issues, or community rights need to be considered. [17]

Secondly, in order to have long-term positive human rights results, and mirroring the requirements for compliance with the minimum safeguards set out in the EU Taxonomy, a human rights due diligence as set out in the UNGPs should be conducted in the context of the investment decision-making process. Doing so will allow the fund to include companies that are in transition to a more human rights friendly strategy in its portfolio.

Building up on the EU Taxonomy, we discuss the criteria that could be used in labels to assess respect for human rights.

The United Nations Guiding Principles on Business and Human Rights (UNGPs) are the authoritative global standards on business and human rights. The corporate responsibility to respect human rights requires (1) the adoption a policy commitment to respect human rights; (2) an ongoing human rights due diligence (HRDD) process to identify, prevent, mitigate and account for how they address their potential impacts on human rights; and finally (3) processes to enable remediation of any adverse human rights impacts they cause or to which they contribute. Find more information here.

The OECD Guidelines for Multinational Enterprises (MEs) set government-backed standards for responsible business conduct covering a range of business sectors and topics such as human rights, labour rights, and the environment. Guidance and support for the implementation of the OECD MEs is provided by the OECD Due Diligence Guidance for Responsible Business Conduct. Find more information here.

The eight ILO Core Labour Conventions cover the four categories identified in the ILO’s Declaration on Fundamental Rights and Principles at Work, which are freedom of association and collective bargaining, the elimination of forced or compulsory labour, the abolition of child labour and the elimination of discrimination in the context of employment and occupation. Find more information here.

The International Bill of Human Rights consists of the Universal Declaration of Human Rights, the International Covenant on Civil and Political Rights and its two Optional Protocols and the International Covenant on Economic, Social and Cultural Rights. Find more information here.

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17 All internationally recognized human rights, understood at minimum, the principles and rights set out in the International Labour Organization’s Declaration on Fundamental Principles and Rights at Work and the International Bill of Human Rights. The United Nations defines human rights as “[…] rights inherent to all human beings, regardless of race, sex, nationality, ethnicity, language, religion, or any other status. Human rights include the right to life and liberty, freedom from slavery and torture, freedom of opinion and expression, the right to work and education, and many more. Everyone is entitled to these rights, without discrimination.” Find more information here.

Which criteria should labels have in place to assess respect for human rights?

While there are better established indicators for measuring environmental impact, such as climate change for instance (e.g. CO2 emissions), indicators for measuring businesses' impact on human rights are still under development. This does not mean that businesses' performance on human rights topics cannot be assessed.

While accurate indicators for measuring the actual impact of business is still to be developed, assessment of businesses' adhesion to the UNGPs is well established. The Corporate Human Rights Benchmark[18] is a good example of that. Therefore, our proposal for a framework to assess respect for human rights lies on ensuring alignment to the UNGPs. We believe that, though this is a good way to start, the business and human rights community should continue its efforts to develop formats to measure impact, so that we can gradually integrate them within assessment frameworks, including those of financial labels.

In line with this approach, we propose the following criteria that labels could use to assess respect for human rights:

Criterion 1: The applicant investment fund has a public commitment to respect human rights and to conduct human rights due diligence (e.g. Human rights policy statement)

As a first step, the applicant investment fund needs to show its clear human rights commitment and set up in clear terms its expectations towards companies the fund invests in. This could be done through a human rights policy statement, following the UNGPs and including the respect of *all* internationally recognised human rights (at minimum, the International Bill of Human Rights and the principles concerning fundamental rights set out in the International Labour Organization's Declaration on Fundamental Principles and Rights at Work).

Criterion 2: The applicant investment fund clearly communicates its expectations regarding human rights due diligence towards investee companies

The applicant investment fund needs to develop and implement a structured process to communicate investee companies about its expectations regarding human rights due diligence.

18 Find more information on the Corporate Human Rights Benchmark here.

Criterion 3: The applicant investment fund adopts an exclusion list as no-go criteria, listing the business sectors in which the fund is not investing

The applicant investment fund should also have an exclusion list as no-go criteria. In general, it should exclude companies expected to violate human rights in the long term. Criteria to be considered include specific sectors and activities, as well as severe violations related to the investee companies' activities. This exclusion list should be applied to 100% of the fund portfolio.

Criterion 4: The applicant investment fund assesses whether the investee companies have policies and procedures in line with the UNGPs, and a minimum percentage of the fund assets relates to investee companies with a good human rights performance

The investment fund would need to show it has a well-structured framework and process to assess companies' alignment to the UNGPs core elements:

"(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;

(c) Processes to enable the remediation of any adverse human rights impacts they cause or to which they contribute."[19]

To conduct this assessment, investment funds could make use of existing tools, e.g.:

- The Corporate Human Rights Benchmark: The Benchmark provides a comparative assessment of some of the largest companies worldwide, "looking at the policies, processes, and practices they have in place to systematise their human rights approach and how they respond to serious allegations".[20]
- Inherent country risk indicators: Indicators such as the Freedom in the World Map,[21] the Corruption Perceptions Index,[22] the Global Slavery Index,[23] the Global Rights Index,[24] the Children's Rights in the Workplace Index,[25] the Fragile States Index,[26] and the Human Development Index[27]

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19 UN Guiding Principles on Business and Human Rights (UNGPs) (2011), principle 15.
20 Corporate Human Rights Benchmark (n.d.): Why a Benchmark?
21 Freedom in the World 2019 evaluates the state of freedom (political rights and civil rights) in 195 countries and 14 territories in 2018 against a series of 25 indicators. Find more information here.
22 The Corruption Perceptions Index 2019 ranks the perceived levels of public sector corruption of 180 countries and territories according to experts and business people. Find more information here.
23 The Global Slavery Index was developed to measure susceptibility to slavery (vulnerability) and government response in 167 countries. Find more information here.
24 The Global Rights Index by the ITUC ranks 145 countries on the degree of respect for workers' rights against a list of 97 indicators. Find more information here.
25 The Children's Rights in the Workplace Index measures the extent to which countries eliminate child labour and provide decent work for young workers, parents and caregivers. Find more information here.
26 The Fragile States Index examines states for their risk of sovereign default. It is composed of twelve different factors. In this context, especially the factor "Human rights and the rule of law" needs to be considered. Find more information here.
27 The United Nations Development Program with the Human Development Index measures the standard of living of people in 189 countries. Find more information here.

- ESG rating reports: Existing ESG rating reports have made efforts to include criteria in line with the UNGPs. Investors making use of these reports, might be able to extract relevant information to be used in their human rights assessment.

- Allegations database: The Business and Human Rights Resource Centre monitors human rights allegations related to business. Also, the OECD National Contact Point database can be consulted and service providers offer allegations databases obtained through media screening.

Additionally, investment funds can add to their methodologies the consultation of human rights experts, NGOs, trade unions, research intuitions, etc. These actors can be key in providing on the ground experience and a broader risk perception perspective.

A minimum percentage (e.g. 70%) of the fund assets must relate to investee companies with a good human rights performance. The applicant must describe the methods and criteria to select the companies with strong human rights performances.

Moreover, the fund should clearly define the responsibilities and roles of those responsible for conducting this process. The fund could consider setting up a Council on Human Rights,[28] for instance.

Criterion 5: The applicant investment fund actively engages with companies to foster improvement on human rights performance

The applicant fund must have a clear strategy to engage with companies in terms of prioritization of efforts and engagement formats.

Prioritization of efforts should be drawn on top of clear criteria which might include sector risks, severe allegations and lower human rights performance.[29]

Typical engagement formats/approaches include:[30]

- Establishment of a voting policy in line with its human rights commitment;
- Monitoring of human rights related issues and regularly voting at AGMs/EGMs;
- Proactive engagement with companies based on a risk analysis;
- Reactive engagement in case of allegations, controversy or scandals.

28 See e.g. the Council on Ethics of Swedish Pension AP Funds
29 UN PRI (2018): Engagement and voting practices
30 ibid

Criterion 6: The applicant investment fund has a whistle-blower system in place through which human rights violations can be reported and addressed in line with the UNGPs

The applicant fund should set up a whistle-blower system through which these cases can be reported and addressed:

- Breaches of its public commitment to respect human rights and to conduct human rights due diligence;
- Allegations of human rights violations by investee companies;

A formal process to handle reported cases should exist and be reported.

Criterion 7: The applicant investment fund reports annually on its process to ensure alignment to the label criteria

Finally, the applicant fund should report annually on:

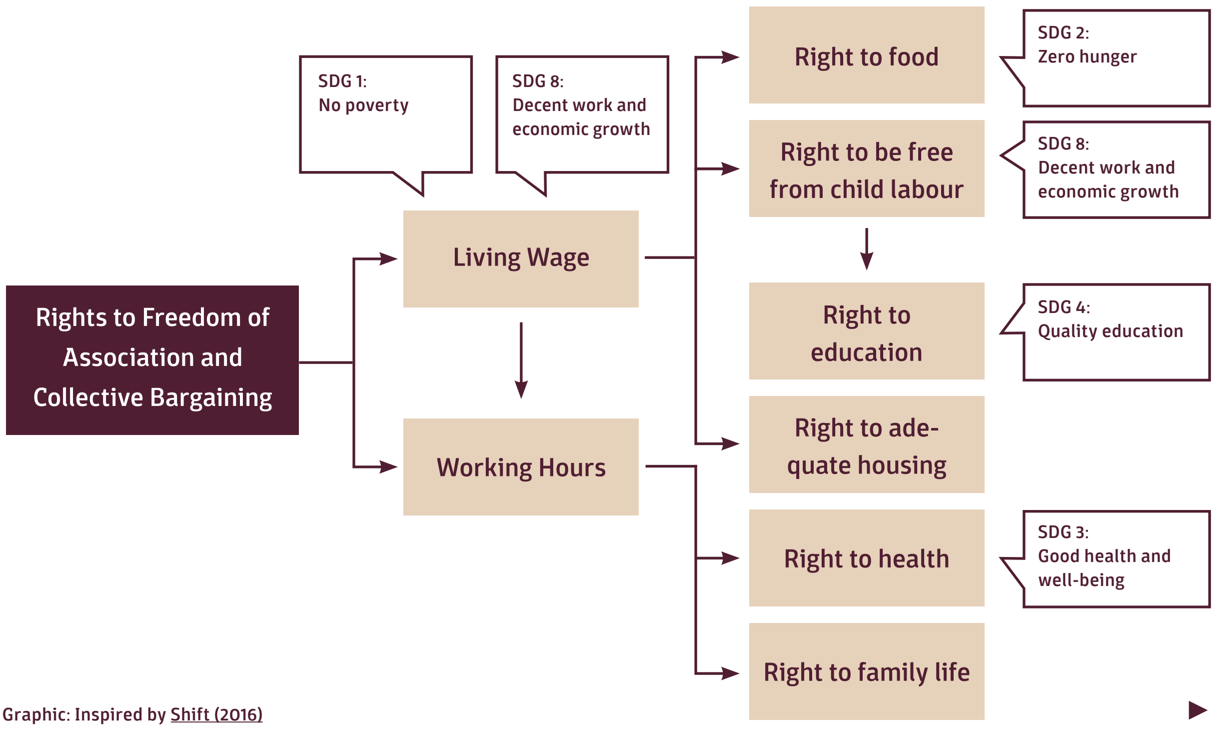
- its commitment to respect human rights and to conduct human rights due diligence;
- how it communicates its expectations regarding human rights due diligence towards investee companies;
- its exclusion list criteria;
- its methodology to assess investee companies' adherence to the UNGPs;
- the percentage of the fund's assets that relates to companies classified as having a good human rights performance;
- the complete list of investee companies;
- its strategy to engage with investee companies to foster improvement on human rights performance;
- human rights allegations addressed through its whistle-blower system; and
- optional: which SDGs are positively impacted through its human rights due diligence.

How can SDGs be integrated into human rights label frameworks?

In an open letter released in 2016, John Ruggie[31] stated his concern related to the risk he sees regarding business discourse around the SDGs.[32] According to him, "when it comes to the social side of the development picture too many companies are quick to jump to promotional initiatives, skipping the essential starting point of reducing negative impacts on people associated with their own business activities and value chains."[33] The core message to convey is that "companies' social development initiatives cannot substitute for measures to address the negative human rights impacts their operations and relationships may have."[34]

In fact, when it comes to human rights aspects, the best way companies can contribute to the SDGs is by advancing respect for human rights through the implementation of the UNGPs. Due diligence is also about driving change by using leverage. For instance, by influencing suppliers to improve health and safety conditions, pay living wages and promote freedom of association.[35]

The figure below provides examples of how business can have an impact on SDGs by ensuring respect for human rights.



Graphic: Inspired by Shift (2016)

31 Professor John Ruggie was the UN Special Representative for Business and Human Rights from 2005 to 2011. He drafted the UN Guiding Principles on Business and Human Rights, which were unanimously endorsed by the UN Human Rights Council in 2011. Find more information here.
32 John Ruggie (2016): The Sustainable Development Goals and the Guiding Principles
33 ibid
34 ibid
35 Shift (2016): Business, human rights and the sustainable development goals forging a coherent vision and strategy

In line with John Ruggie's statement, we advocate that labels should avoid using alignment to specific SDGs as the sole criteria regarding human rights performance. A company can contribute to SDG4 Quality on Education, for instance, by adopting philanthropic initiatives to finance schools. It does not mean that this company is making its efforts to conduct due diligence to avoid potential harms caused by its operations and business relations.

We believe that the use of labels can encourage investment funds and investee companies to assess how their implementation of the UNGPs can contribute to the SDGs. As the financial sector has a key role in pushing further the realisation of these goals, this connection is truly relevant for measuring its contribution.

Moving forward

This paper aims to contribute to the more than needed debate around the integration of human rights in investment practices. The increased focus on "S" and in turn its subsequent focus on human rights, especially in these times of crisis, reflects a broader shift in the financial sector. Hence its integration is fundamental.

We propose a clear framework to be used by labels to ensure integration of human rights within their criteria for funds. Assessment of businesses' adhesion to the UNGPs is well established and, therefore, the framework proposed in this paper focuses on assessing alignment to the UNGPs. This approach is also meant to be the basis for other financial products (e.g. pension, banking or insurance products).

Still we believe it is crucial to find ways to verify the effectiveness of human rights due diligence procedures by getting closer to measuring real impact on the ground. More research and development are needed to reach this target.

Feel free to get in touch if you're interested to discuss!

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Finance & Human Rights (FaHR)

is a non-profit organisation created in 2019. It serves as a knowledge hub that brings together strong expertise on business & human rights with extensive experience in the financial sector.

The financial industry has substantial leverage on tackling human rights issues in global corporate value chains, especially in the context of investment decision-making processes. While there is a strong focus on climate and environmental issues in sustainable or ESG finance (Environment-Social-Governance), we should not lose sight of human rights, or the “S” in ESG. Therefore, FaHR seeks to provide various stakeholders from the financial sector with its broad knowledge on how they can use their power to respect and promote human rights. Click here to visit our website.

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