Concluding Remarks on Corporate Due Diligence and Sustainable Finance

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The fifth episode of the webinar series "Business, Human Rights and the Environment in Europe: Connecting the Dots" took place on the 27th of May 2021 and addressed the relationship between corporate due diligence and sustainable finance. The panel was composed by Celine Tan (Warwick Law School), Daria Davitti (Lund University), Phil Bloomer (Business and Human Rights Resource Center), Robin Brooks (Norton Rose Fulbright), Rodrigo Tavares (NOVA SBE and Granito Group), Tara Van Ho (Essex University), Tyler Gillard (OECD), and it was chaired by Paloma Muñoz Quick (UN Working Group on Business & Human Rights – UNGPs 10+ / Next Decade BHR).

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Paloma Muñoz Quick started the discussion outlining the unparallel global challenges we are facing with growing inequalities and the climate crisis and how financial institutions have a systemic influence to achieve a sustainable path, as they fuel economies. She explained how sustainable finance is "a process by which financial institutions take into account Environmental, Social and Governance (ESG) considerations, when it comes to their investment decisions". In particular, one of the key questions that remains is how to practically scale sustainability to ensure that sustainable finance is effective. Paloma mentioned how the UN Guiding Principles on Business and Human Rights (UNGPs) clarify that the responsibility to respect human rights applies to the entire spectrum of the financial institutions, including commercial banks, institutional investors, assets management firms, pension funds, insurance companies, that is why the responsibility to respect human rights must always be a core element of the sustainable finance.

Phil Bloomer addressed the issue of what is currently driving the ESG trend and highlighted the most recent successes, like the Dutch Court ruling on Shell, which demonstrated the growing scale of the ESG investors and their cooperation, increased assertiveness, and influence in markets. He explained that since the global economic crisis of 2008, global finance has been associated with rising inequalities, precarious work, climate breakdown, and systematic tax avoidance and evasion, and at the same time there is a sense of "financialization of everything" including health and education services. In reacting to these unfairness and inequalities, Phil indicated that it was left to a collection of civil society organizations, multilateral institutions and a cluster of more responsible businesses and investors to call for a more sustainable future and for political parties to understand the need for "economies and financial markets that deliver shared prosperity and shared security rather than a winner takes it all and race to the bottom on workers' rights and environmental standards". All this has led to a change in the behaviour of governments, which became more attentive to human rights and the environment and started regulating both companies and the financial sector. Phil gave some examples of this regulation, such as the upcoming EU directive on human rights and environmental due diligence, the UK Modern Slavery Act, the bans from the United States (US) on goods suspected of forced labour and the Green Taxonomy alongside with the European sustainable finance initiatives. As he explained, it is necessary to respond to current changes, especially the concerns of asset owners and asset managers who fear the risks of their assets impacts on the environment and on workers but also the lack of preparation for possible legislative changes.

Tyler Gillard talked about the work of the OECD around sustainable finance and its connection with the recent developments in Europe. According to Tyler, when dealing with standards on ESG investing there seems to be a conflict, because, on the one hand, there is a significant number of standards, mostly private ones not aligned with global benchmarks, and, on the other hand, a "vacuum" in global authoritative government-backed standards that are developed with different stakeholders, communities, and businesses. He clarified that the financial institutions have the same responsibilities as other businesses, to respect human rights and the environment. The OECD's work on Responsible Business Conduct is anchored in the implementation of the OECD Guidelines for Multinational Enterprises, which are aligned with the UNGPs since its revision in 2011 and the introduction of a Human Rights Chapter. Regarding the work of the OECD, he mentioned the work of the National Contact Points, which are national bodies that promote the OECD Guidelines and respond to complaints, and how they have received more cases regarding financial institutions because of the knowledge brought by the UNGPs. Moreover, he also referred to the standards created, since 2015, for different types of financial services, to adapt due diligence in this sector to the different nuances of each financial service: the publication in 2017 of a due diligence framework for institutional investors, including asset owners and asset managers, given the growth of debt finance; the launch, in 2019, of due diligence guidance for responsible corporate lending and securities underwritings; and, lastly their current work on a new standard related to project and asset finance. Tyle concluded by saying that there are still some massive blind spots on sustainable finance and corporate lending is where we need to look at.

Then the discussion centred around two essential questions about sustainable finance, profitability and its challenges, which were answered by Rodrigo Tavares. Regarding the first issue, Rodrigo considered that the answer would depend on different factors, although there have been recent studies by the New York University and Rockefeller Asset Management from 2015 and 2020 which concluded that "59% of these individual studies showed that ESG-related investments have similar or better performance relative to conventional investment approaches". So, as indicated by Rodrigo, in academia there is an inclination to believe that there are strong correlations between ESG and financial performance. As for the second question, he explained that the challenges presented are related to (1) data collection, analysis and reporting, given the number of frameworks and rating agencies; (2) assessing materiality, because there are ESG asset managers lacking the capacity to identify the relevant ESG indicators; (3) the lack of products, especially "high yield and IG fixed income products"; and (4) the issue of greenwashing, which can be voluntary or involuntary, as there is no global standard or framework to prevent unwittingly wrong classifications from being made. The speaker also addressed the new initiative of the British Standards Institute (BSI) and ISO which aims to be a classification system for responsible and sustainable investment funds and emerges as a joining of forces between the British Government, BSI, and financial houses to combat greenwashing. As he mentioned, this standard will be "prescriptive and rules based", therefore it would establish minimum provisions/features for an investment to be considered a responsible or sustainable one and covers all asset classes, as well as both sustainable and responsible investment practices.

Afterwards, Daria Davitti discussed the current EU process and how it could promote coherent action on financial investments. Daria explained that on the 21st of April 2021 the EU presented a sustainable financing package that targets economic activities on this path and includes a key factor in the taxonomy – it contains screening criteria. This allows us to understand which activities can be selected as sustainable in terms of climate change mitigation and adaptation. However, as she emphasised, there are three key aspects of the April package which will be problematic for the financial sector or for corporations when it comes to disclosure. The three problems relate to the fact that natural gas is considered a transitional activity, and that bioenergy and forestry are considered sustainable activities, which is problematic in terms of reducing or not reducing greenhouse gas emissions. Thus, Daria believes that the EU seems to have missed an opportunity to take the lead in a proper way and from the legal point of view it will create great difficulties. Regarding the just transition issue, she explained that it should take into consideration the gradual elimination in the sorting sector and that this is possible without a continued need for the use of fossil fuels. As she indicates, this process is relevant for the financial sector because of what they will have to declare will be linked to the screening criteria, which in turn is linked to the data from the regulations that the financial sector and its various institutions will collect. The speaker explained that there is a threat of non-protection because there are differences between a limited and a reasonable assurance in terms of the audit requirements and in the EU proposal, they have accommodated limited assurance which means that there will not be many requirements for a more detailed reporting. Therefore, according to Daria, the EU is setting the bar too low.

Phil Bloomer also added that is essential to insist with the regulators to have a "high quality level playing field" with standardized and harmonized frameworks and ensure that the "green taxonomy does not mean greenwashing".

Celine Tan described the current trends in the investment markets sector, where there is "a shift away from development financiers as direct funders of development projects and programs" to "brokers of development financing". As she explained, the narrative is of de-risking private investment to "encourage financial markets to move into traditionally public sector areas", so a lot of development financing is going to improve the risk-return profile of projects to catalyst private investment, which is problematic for several reasons. Celine considers the issue of sustainability of financial markets as a source of development finance and the fact that there is not enough discussion about the risks of using financial markets. For instance, as she argues, at the beginning of the pandemic, there was a massive outflow of finance from emerging markets which created a lot of instability, especially in developing countries which are still subject to these unstable capital flows. Celine clarified that what we have today are existing financial instruments which already have their own problems, being used for sustainable development investment, without often safeguarding the communities. She stated that there are still many problems regarding the sustainability and stability of financial markets, highlighting the regulatory gaps that arise from the lack of control over inflows and outflows from developing countries. Celine concluded that despite the trends we have been seeing, we are still far from having the necessary regulatory architecture.

Tara Van Ho then elaborated on the responsibilities of the financial sector, she distinguished between those that concern State actors and those that concern businesses. Those of the former are more wide-reaching, referring to the duty to respect, protect and fulfil human rights. It is in this set of responsibilities that the obligation to create regulations on human rights for financial actors is inserted. Unfortunately, as Tara explained, we are still far from the ideal in most countries, although the French Corporate Duty of Vigilance

Law can be mentioned as a positive example which applies to investors not just to companies, but most investors will not be covered by the law because they do not have a sufficient number of employees. However, when enforcing obligations through mandatory due diligence this will apply to financial investors. Regarding the responsibility of businesses to undertake human rights due diligence, she explained the factors that help us understand if a company or investor has caused or contributed to human rights adverse impacts, which are: (a) the power and independence they have to influence the realisation of the harm, in other words, if they directly caused the harm or if they could stop their involvement; (b) the severity and the predictability of the harm, because the greater these are the more likely they are to be contributing or causing harm and the greater the responsibility to adopt mitigation measures; (c) the adoption or not of standard mitigation measures. Tara concluded by commenting on the enforceability of the obligation to provide reparations at the domestic level, for instance, at the Okpabi case where it was shown that when a company publicly assumes certain responsibilities and publicly promotes that it has worked on them, then this constitutes an assumption of responsibilities, meaning they can be held accountable.

Robin Brooks focused on the legal implications of human rights and environmental due diligence for financial institutions, particularly looking at project finance. He clarified that over the last 20 years there has been some form of human rights due diligence and in several projects that would identify the risk of harm and the risk of infringement of rights, making these risks potentially foreseeable. He highlighted the approach of the English courts under the English Tort Law which would look at the question of “Who was responsible for instigating what action and who assumed what responsibility?”, although not focusing on the complexities of the corporate structure. He then mentioned two recent English court cases, *Begum v. Maran* (2021) and *Fish v. Shepherd ‘Operation Blue Range ’* (2015), dealing with the issue of liability through contractual relationship instigating harm and accessory liability. He also commented on the fact that investors’ responsibilities do not end once the investment is made, it continues beyond that. Robin argued that some lessons can be learned from the regulation of financial institutions, especially anti-money laundering and terrorism, because its global reach and accountability. He concluded by saying that the correct approach for a financial institution is to do proper financial due diligence on human rights and environmental matters and carry out the necessary processes to manage and/or avoid risks.

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