Human Rights Obligations in the Financial Sector: Investors' Responsibility to Respect Human Rights and ESG inconsistencies

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Abstract

The financial sector's power and impact on human rights are increasingly examined. Examples from all over the world uncover how financial organizations and their services adversely impact human rights. This thesis examines the persisting challenges in the implementation of international soft law frameworks by financial organizations, in particular, because, despite growing recognition of the financial sector's role in human rights, current approaches still rely heavily on voluntary measures and soft law standards. This thesis explores, specifically the UN Guiding Principles on Business and Human Rights (UNGPs) and the OECD Guidelines for Multinational Enterprises (OECD Guidelines), as applied to the financial sector, with a focus on investment services. First, there is an overview of these challenges, highlighting the ambiguity surrounding the obligations of financial organizations to respect human rights and emphasizing the need for clarity and specific guidance in interpreting these standards. This is important since financial organizations, with varied financial services in investing, remain invisible to the victims of human rights harm, undermining their responsibility. Subsequent chapters delve deeper into the content of the Human Rights Due Diligence process specifically regarding financial organizations and highlight the issues around the role of the Human Rights Due Diligence. Following that, the focus is on parts of the Human Rights Due Diligence processes, especially concerning the responsibility to address human rights risks before investing, identification of levels of involvement with abuses throughout the investment lifecycle, and the role of leveraging influence for human rights impacts. Simultaneously, this thesis offers comparative examples of how ethical business-led initiatives such as environmental, social, and governance (ESG) are not aligned with expected human rights responsibilities. Through analysis and discussion, this thesis aims to contribute to a better understanding of how financial organizations can fulfill their expected human rights

responsibilities and ensure responsible business conduct in the context of human rights protection.

Keywords: *Human Rights Due Diligence in investing, Finance and Human Rights, ESG Investing, Human rights obligations and investments, Responsible investing, Human rights risk assessment in investing, Corporate Social Responsibility*

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LIST OF ABBREVATIONS

UNGPs – United Nations Guiding Principles on Business and Human Rights

OECD – Organizations for Economic Cooperation and Development

OECD Guidelines – OECD Guidelines for Multinational Enterprises

HRDD – Human Rights Due Diligence

1. INTRODUCTION

1.1 Shifting trends

The complex relationship between finance and human rights has come under increasing scrutiny in recent years, as the financial sector's potential impact on social well-being becomes undeniable.[1] This trend is further amplified by the significant global shift from public to private development financing, which has numerous implications for human rights.[2] Ongoing changes in the financial industry are increasingly addressing sustainability challenges by adopting a range of strategies, including voluntary business-led initiatives[3], soft law guidelines, and more recently, mandatory reporting and due diligence laws that address financial organizations' responsibilities towards human rights and the environment.[4] These initiatives are gaining mainstream attention and are becoming integral to the industry's approach to sustainability and ethical practices. Public concerns of this nature are significant because "the global financial system has expanded so rapidly and become so integrated that it is now the preeminent driving force shaping patterns of world trade and economic growth, which critically underpin human rights realization"[5].

[1] George G BRENKERT, "Business Ethics and Human Rights: An Overview," *Business and Human Rights Journal* 1, no. 2 (2016): 304–6, https://doi.org/10.1017/bhj.2016.1.
[2] "Privatising Development: Project Finance Law and Human Rights in: Privatising Development," 15–20, accessed June 14, 2024, https://brill.com/display/book/edcoll/9789047407300/front-3.xml.
[3] Jonathan R. Macey, "ESG Investing: Why Here? Why Now?," *Berkeley Business Law Journal* 19, no. 2 (2022): 258–59.
[4] Karin Buhmann, "Neglecting the Proactive Aspect of Human Rights Due Diligence? A Critical Appraisal of the EU's Non-Financial Reporting Directive as a Pillar One Avenue for Promoting Pillar Two Action," *Business and Human Rights Journal* 3, no. 1 (January 2018): 23–28, https://doi.org/10.1017/bhj.2017.24.
[5] Mary Dowell-Jones and David Kinley, "Minding the Gap: Global Finance and Human Rights," *Ethics & International Affairs* 25, no. 2 (July 2011): 185, https://doi.org/10.1017/S0892679411000062.

Historically, human rights scholarship has struggled to comprehensively address the macro-scale impacts of financial markets, which remains a challenge.[6] The predominant focus has been on examining the direct effects of financial organizations on human rights at a 'micro' level within the framework of corporate responsibility towards human rights.[7] For instance, efforts have been made to resolve Discriminatory Lending Practices that appeared in USA.[8] However, the more indirect effects of financial services at the micro level, for example, the human rights impacts of Private Equity investors, have only recently started gaining attention, necessitating further research and clarification.[9]

At the micro level, financial organizations may inadvertently cause adverse impacts by prioritizing companies' financial performance without considering their broader social and environmental consequences. This is a complex set of issues. For example, apart from the typical business and human rights perspective where foreign multinational companies exploit weak human rights protections in developing countries, scholars have identified that companies from developing countries are also more prone to causing human rights harm in their countries of origin to achieve greater financial performance and remain competitive globally.[10] By considering only financial performance in their investment services, financial organizations may inadvertently associate with companies involved in human rights abuses, thereby benefiting from these unethical practices. Moreover, by failing to comply with human rights standards, their impacts extend to other industries as well.

[6] Dowell-Jones and Kinley, 187.
[7] Dowell-Jones and Kinley, 187.
[8] Folger, Jean. "The History of Lending Discrimination." Updated January 17, 2024. Accessed June 16, 2024. https://www.investopedia.com/the-history-of-lending-discrimination-5076948.
[9] David Birchall and Nadia Bernaz, "Business Strategy as Human Rights Risk: The Case of Private Equity," *Human Rights Review* 24, no. 1 (March 1, 2023): 2–8, https://doi.org/10.1007/s12142-023-00680-w.
[10] "Big Profits, Big Harm? Exploring the Link Between Firm Financial Performance and Human Rights Misbehavior," 1277–81, accessed June 12, 2024, https://doi.org/10.1177/00076503221144994.

1.2. Financial sector and human rights concerns – a complex issue

Historically, the lack of integration of human rights considerations within the financial sector, kept finance and human rights separate for a significant time.[11] At present, specific financial practices, as mentioned private equity investing, disregard human rights concerns and are criticized for being construed to even gain profits out of human rights risks.[12] Moreover, the complexities of these financial services have led to the business and human rights frameworks initially overlooking the specific impacts associated with the finance sector's links to human rights violations.

The adverse impacts of the financial sector in its business and client relationships differ based on its role and the specific services provided. Therefore, it is critical to assess which role a financial organization has in its client and business relationships and to what extent financial services could be aligned with human rights responsibilities. Assessment of these dynamics offers added value since the leverage that financial organizations have over their business relationships is higher compared to other industry sectors.[13] Emphasizing human rights concerns aims to address the question of how society wants the financial sector to function as a business.[14] Hence, this thesis will mainly focus on investment business relationships.

1.3. Non-exercise of leverage, persistent invisibility and recent increased attention

[11] Mary Dowell-Jones, "Financial Institutions and Human Rights," *Human Rights Law Review* 13, no. 3 (September 1, 2013): 426, https://doi.org/10.1093/hrlr/ngt018.
[12] Birchall and Bernaz, "Business Strategy as Human Rights Risk," 10–14.
[13] Chiara Macchi and Nadia Bernaz, "Business, Human Rights and Climate Due Diligence: Understanding the Responsibility of Banks," *Sustainability* 13, no. 15 (January 2021): 8391, https://doi.org/10.3390/su13158391.
[14] BRENKERT, "Business Ethics and Human Rights: An Overview," 304–6.

Leverage, in the context of corporate responsibility and human rights, refers to the ability or power of a corporation to influence the behavior and actions of other entities or individuals.[15] This can include suppliers, business partners, and other stakeholders. A corporation's leverage can be used to encourage or require these actors to adhere to certain standards or practices, particularly concerning human rights.[16] Leverage is significant because it recognizes that while a corporation may not directly cause a human rights violation, it may have the capacity to prevent or mitigate such violations through its influence over other parties.[17] Frequently, particularly within investing services, the leverage that financial organizations possess is not efficiently exercised. This undermines the role of the leverage-based corporate human rights responsibility.[18] The roles and services of the financial sector have been addressed directly by international soft law[19] standards, which, while legally nonbinding, carry significant legal consequences and influence corporate behavior. Yet, the role and leverage that financial organizations have are rarely utilized.

Recently, there has been a notable increase in attention, especially in business and human rights literature, towards the financial sector. This growing awareness reflects a shift in focus towards understanding and addressing the impacts of financial activities on human rights.[20] Scholars started questioning how financial organizations can use their leverage to influence businesses and encourage respect for human rights.[21] Investors were identified as key actors in enhancing the human rights respect and responsibility of companies.[22] Hence, the main

[15] Julia Ruth-Maria Wetzel, "Business and Human Rights at the UN," in *Human Rights in Transnational Business: Translating Human Rights Obligations into Compliance Procedures*, ed. Julia Ruth-Maria Wetzel (Cham: Springer International Publishing, 2016), 173–74, https://doi.org/10.1007/978-3-319-31325-2_6.
[16] Wetzel, 173–74.
[17]Wetzel, 173–74.
[18] Stepan Wood, "The Case for Leverage-Based Corporate Human Rights Responsibility," *Business Ethics Quarterly* 22, no. 1 (January 2012): 63–98, https://doi.org/10.5840/beq20122215.
[19] Andrew T. Guzman & Timothy L. Meyer, International Soft Law, 2 Journal of Legal Analysis 171-225 (2010)
[20] Surya Deva et al., "Editorial: Business and Human Rights Scholarship: Past Trends and Future Directions," *Business and Human Rights Journal* 4, no. 2 (July 2019): 207, https://doi.org/10.1017/bhj.2019.17.
[21] Deva et al., 206.
[22] Deva et al., 206.

focus remains on the convergence of norms that govern the roles and responsibilities of banks and other financial actors, acknowledging the essential role of private sector finance in safeguarding human rights.[23] Examples could be seen in some countries, members of the European Union, that started adopting mandatory human rights due diligence laws.[24] However, those mandatory laws also face challenges.[25]

Simultaneously, serious considerations of the financial sector's responsibility to respect human rights emerged after the financial crisis, which influenced the EU to address the lack of human rights concerns in the financial sector.[26] The key first step in this initiative was enhancing transparency and visibility.[27] Thus enhancing the visibility of financial organizations to victims of human rights abuses. Following that, the importance of investors' responsibility to respect human rights and the urge for greater clarification, was emphasized in the latest thematic Report[28] of the UN Working Group on the Issue of Human Rights and Transnational Corporations and Other Business Enterprises. The Working Group highlighted the crucial role of investors, and the significance of already established business practices, within the financial sector in implementing the UNGPs and noted that financial actors possess a unique capacity to influence companies and accelerate progress on these principles.

[23] Deva et al., 206.
[24] Gabriela Quijano and Carlos Lopez, "Rise of Mandatory Human Rights Due Diligence: A Beacon of Hope or a Double-Edged Sword?," *Business and Human Rights Journal* 6, no. 2 (June 2021): 241, https://doi.org/10.1017/bhj.2021.7.
[25] Robert McCORQUODALE et al., "Human Rights Due Diligence in Law and Practice: Good Practices and Challenges for Business Enterprises," *Business and Human Rights Journal* 2, no. 2 (July 2017): 206, https://doi.org/10.1017/bhj.2017.2.
[26] Julia Ruth-Maria Wetzel, "Targeting Corporate Human Rights Conduct from a Multinational Perspective," in *Human Rights in Transnational Business: Translating Human Rights Obligations into Compliance Procedures*, ed. Julia Ruth-Maria Wetzel (Cham: Springer International Publishing, 2016), 128, https://doi.org/10.1007/978-3-319-31325-2_5.
[27] Wetzel, 128.
[28] Working Group on the Issue of Human Rights and Transnational Corporations and Other Business Enterprises. 2024. "Investors, Environmental, Social and Governance Approaches and Human Rights - Report of the Working Group on the Issue of Human Rights and Transnational Corporations and Other Business Enterprises." United Nations Human Rights Council, A/HRC/56/55, May 2, 2024. https://www.ohchr.org/en/documents/thematic-reports/ahrc5655-investors-environmental-social-and-governance-approaches-and

Regardless, at COP 28 several CSOs claimed that financial actors are driving climate change and human rights abuses in tropical forest regions.[29] Additionally, reports uncovered the involvement of several banks from the UK and Switzerland in abuses of human rights by private prisons.[30] These realities portray the ongoing struggle and persistent neglect of soft law standards by financial organizations in upholding their responsibilities towards human rights, despite holding a unique and influential position within the global economy.

1.4. Emergence of ESG and CSR initiatives and challenges of soft law standards

On the other hand, an attempt to render businesses more sustainable gained significant momentum after the adoption of the UN Sustainable Development Goals in 2015 as a critique of existing business practices, in which finance plays an important role.[31] As financial businesses responded, various CSR (Corporate Social Responsibility) initiatives which appeared previously, for instance, religious communities excluded some 'sin' investment or boycotting companies that provide guns in Vietnam war, offered solutions.[32] These different practices were later on employed in an attempt to strengthen the sustainability of financial systems and markets.

[29] https://www.business-humanrights.org/en/latest-news/a-new-report-finds-esg-policies-of-global-banks-and-investors-insufficient-and-play-significant-role-in-driving-climate-change-and-human-rights-abuses-in-tropical-forest-regions/, accessed on 25.03.2024.
[30] https://www.business-humanrights.org/en/latest-news/uk-switzerland-civil-society-groups-file-oecd-complaint-against-4-banks-over-financial-involvement-with-private-prison-operators/, accessed on 25.03.2024.
[31] Caroline D. Ditlev-Simonsen, "Sustainability and Finance: Environment, Social, and Governance (ESG)," in *A Guide to Sustainable Corporate Responsibility : From Theory to Action*, ed. Caroline D. Ditlev-Simonsen (Cham: Springer International Publishing, 2022), 2, https://doi.org/10.1007/978-3-030-88203-7_9.
[32] Alice Martini, "Socially Responsible Investing: From the Ethical Origins to the Sustainable Development Framework of the European Union," *Environment, Development and Sustainability* 23 (November 1, 2021): 16881, https://doi.org/10.1007/s10668-021-01375-3.

The crucial business-driven practice emerged as the 'ESG' (Environment, Social, and Governance) investing, known as an investment strategy that incorporates environmental, social, and governance (ESG) factors into the process of selecting and managing a portfolio.[33] Essentially, the ESG investing is simply taking into account non-financial information in the decision-making processes which entails human rights considerations as well. This practice recognized as 'socially responsible investing' has several different terms such as impact investing, responsible investing, or ethical investing all defining similar practices that will be used interchangeably in this thesis.[34] In essence, impact investing is an investment strategy aimed at generating financial returns while creating a positive social or environmental impact, with investors considering a company's commitment to corporate social responsibility and its duty to positively serve society.[35]

Hence, ESG and Impact investing are connected to the Corporate Social Responsibility (CSR) initiatives. CSR involves businesses incorporating social and environmental concerns into their operations and stakeholder interactions.[36] It aims to balance profit-making with sustainable development and community well-being, often going beyond legal requirements.[37] Initiatives like this have their importance in dealing with human rights. However, even Corporate Social Responsibility (CSR) initiatives can inadvertently lead to adverse human rights impacts. Consequently, ESG is an additional tool to assess companies' performance on non-financial factors, namely the environmental, social, and governance in investing.[38]

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[33] Martini, 16875.
[34] Martini, 16875.
[35] Chen, James. "Impact Investing: Definition, Types, and Examples." Updated March 03, 2024. Accessed June 08. 2024. https://www.investopedia.com/terms/i/impact-investing.asp.
[36] Magdalena Kaźmierczak, "A Literature Review on the Difference between CSR and ESG," *Scientific Papers of Silesian University of Technology. Organization and Management Series* 2022 (January 1, 2022): 277–79, https://doi.org/10.29119/1641-3466.2022.162.16.
[37] Kaźmierczak, 279.
[38] Ali Murad Syed, "Environment, Social, and Governance (ESG) Criteria and Preference of Managers," ed. Collins G. Ntim, *Cogent Business & Management* 4, no. 1 (January 1, 2017): 2–3, https://doi.org/10.1080/23311975.2017.1340820.

These initiatives, being voluntary, proved to have limited effectiveness, lacking material information, transparency, and comparability.[39] Moreover, they suffered criticism of whether they were ethically driven or profit-driven activities.[40] Regardless, the scope of ESG investing activities broadened, developing into a form of 'social investing' approaches which encompass diverse practices such as negative/exclusionary screening, positive/best-in-class screening, norms-based screening, sustainability-themed investing, impact investing, community investing, integration of ESG factors, and corporate engagement and shareholder advocacy.[41] Yet, their efficiency towards safeguarding human rights and alignment between the ESG and human rights throughout their operations stayed limited and profit-driven.[42]

As mentioned, the EU adopted legislation to utilize these practices, mandating companies to disclose ESG information to enhance transparency and foster respect for human rights.[43] Comparatively, mandatory disclosure of non-financial information emerged as a global trend adopting similar laws in China and South Africa also,[44] which signalizes the growing need for standardized ESG information globally. The effects of these regulations remain questionable.[45] Hence, the ongoing debate concerns whether hard law should prescribe how financial organizations should use mandated ESG disclosing, or if a market-driven, self-regulatory approach is preferable to ensure responsible business practices.[46]

[39] Luis Torres et al., "The Potential of Responsible Business to Promote Sustainable Work – An Analysis of CSR/ESG Instruments," *Safety Science* 164 (August 1, 2023): 8, https://doi.org/10.1016/j.ssci.2023.106151.
[40] Linda-Eling Lee, "ESG Investing: Financial Materiality and Social Objectives," in *Pension Funds and Sustainable Investment: Challenges and Opportunities*, ed. P. Brett Hammond, Raimond Maurer, and Olivia Mitchell (Oxford University Press, 2023), 93–98, https://doi.org/10.1093/oso/9780192889195.003.0004.
[41] Martini, "Socially Responsible Investing," 16877.
[42] Jaap Bartels and Willem Schramade, "Investing in Human Rights: Overcoming the Human Rights Data Problem," *Journal of Sustainable Finance & Investment* 14, no. 1 (January 2, 2024): 206, https://doi.org/10.1080/20430795.2022.2053943.
[43] Buhmann, "Neglecting the Proactive Aspect of Human Rights Due Diligence?"
[44] Diogenis Baboukardos et al., "The Multiverse of Non-Financial Reporting Regulation," *Accounting Forum* 47, no. 2 (April 3, 2023): 149–51, https://doi.org/10.1080/01559982.2023.2204786.
[45] David Hess, "The Transparency Trap: Non-Financial Disclosure and the Responsibility of Business to Respect Human Rights," *American Business Law Journal* 56, no. 1 (2019): 5–53, https://doi.org/10.1111/ablj.12134.
[46] Martini, "Socially Responsible Investing," 16885.

Conversely, the rise of greenwashing and the dissemination of false information in corporate disclosures have led to increasing litigation, highlighting the inadequacies of voluntary approaches as well.[47]

1.5. Emergence of mandatory sustainability laws

Following that, mandatory sustainability laws should influence change within the established corporate governance structure in finance organizations. The inclusion of the financial sector would impact the ongoing broader debates about the shareholder's activism regarding human rights concerns.[48] Additionally, scholars noted the implications of mandatory human rights due diligence impacts on the double materiality in corporate decision-making, considering benefits for shareholders and stakeholders together.[49] Nevertheless, acknowledging the ongoing nature of this process, this thesis seeks to offer a comprehensive overview to clarify existing uncertainties and misalignments.

1.6 The goal of the thesis

In essence, this master thesis aims to assess and identify the challenges of the current state of legal frameworks that govern financial organizations and human rights. The elaborated

[47] "Human Rights Abuses from Carbon Credits – A Critique of 'Greenwashing' Lawsuits and Additional Litigation Techniques – Environmental Law Journal," accessed March 28, 2024, https://www.nyuelj.org/2024/01/human-rights-abuses-from-carbon-credits-a-critique-of-greenwashing-lawsuits-and-additional-litigation-techniques/.

[48] Malcolm Rogge, "Humanity Constrains Loyalty: Fiduciary Duty, Human Rights, and the Corporate Decision Maker," *Fordham Journal of Corporate & Financial Law* 26, no. 1 (January 1, 2021): 1.

[49] Katrin Hummel and Dominik Jobst, "An Overview of Corporate Sustainability Reporting Legislation in the European Union," *Accounting in Europe* 0, no. 0 (2024): 1–36, https://doi.org/10.1080/17449480.2024.2312145.

soft law standards developed, through interpretations, and shaped responsible conduct which financial organizations should put in place to meet their responsibility to respect human rights throughout their services.

However, several uncertainties and misunderstandings pertain to challenging the implementation of those standards. Selected challenges will be analyzed in this master thesis in an attempt to provide further clarification regarding this growing field.

Moreover, while ESG investing offers a suitable mechanism to ensure the financial sector's respect for human rights, these practices exhibit certain inconsistencies with expected responsibility. Selected inconsistencies will be analyzed to assess and highlight the need for greater alignment.

1.7. Research and methodology

In terms of methodology, this master's thesis holds the perspective of business and human rights scholarship.[50] The field was conceptualized by the work of John Ruggie[51] in addressing transnational violations of human rights by multinational companies within the international human rights law.[52] Moreover, it focuses on the legal responsibility to respect human rights as defined in the UNPGs.[53] Therefore, the main focus is directed towards the legal sources which directly address businesses on international level. Moreover, scholars have

[50] Nadia Bernaz, *Business and Human Rights: History, Law and Policy - Bridging the Accountability Gap* (London: Routledge, 2016), 1–9, https://doi.org/10.4324/9781315626055.
[51] John Ruggie was a renowned political scientist and international relations scholar, who made significant contributions in business and human rights. He is best known for developing the UN Guiding Principles on Business and Human Rights, a framework for states and businesses to address human rights impacts.
[52] John Gerard Ruggie, *Just Business: Multinational Corporations and Human Rights* (W.W. Norton, 2013).
[53] United Nations Human Rights Council, Guiding Principles on Business and Human Rights: Implementing the United Nations Protect, Respect and Remedy Framework (A/HRC/RES/17/13, March 21, 2011), available at https://www.ohchr.org/Documents/Issues/Business/Intro_Guiding_PrinciplesBusinessHR.pdf

argued that the financial industry has lost its legitimacy because of human rights concerns, thus this recognition highlights the necessity for transformation.[54] Moreover, this thesis tries to identify implications for bridging the human rights accountability gap for human rights harm caused by but also linked with the financial organization's services. Also, it conveys the idea of how would financial actors use their leverage to enhance human rights respect within the business sphere. Additionally, it examines ESG practices, as opposed to business and human rights scholarship, since it rests on the idea "that business has responsibilities beyond profit maximization and towards society at large"[55]. This master thesis examines what are the challenges of existing human rights due diligence practices and uncertainties and thus provides more clarification. Therefore, based on the business and human rights scholarship, this research aims to perform a normative analysis of international, soft law, and voluntary standards. Sources for analysis are legal texts and official documents, as well as scholarly literature. Furthermore, it will explore inconsistencies between the United Nations Guiding Principles on Business and Human Rights (UNGPs)[56] and OECD Guidelines for Multinational Enterprises (OECD Guidelines)[57] with voluntary business initiatives such as ESG. Lastly, this research examines the case law brought before the National Contact Points (NCPs) in the countries that are members of the Organization for the Economic Cooperation and Development (OECD) and acknowledges the lack of similar cases indicating some of the uncertainties and thus the ongoing lack of implementation. The lack of cases brought against financial organizations for human

[54] Rosa M. Lastra and Alan H. Brener, "Justice, Financial Markets,and Human Rights," in *Just Financial Markets?: Finance in a Just Society*, ed. Lisa Herzog (Oxford University Press, 2017), 0, https://doi.org/10.1093/oso/9780198755661.003.0002.
[55] Bernaz, *Business and Human Rights*, 3.
[56] United Nations Human Rights Council, "Guiding Principles on Business and Human Rights: Implementing the United Nations 'Protect, Respect and Remedy' Framework," A/HRC/17/31 (21 March 2011), accessed June 15, 2024, https://www.ohchr.org/documents/publications/guidingprinciplesbusinesshr_en.pdf.
[57] Organisation for Economic Co-operation and Development, *OECD Guidelines for Multinational Enterprises*, accessed June 15, 2024, https://www.oecd.org/investment/mne/1922428.pdf.

rights harm highlights significant obstacles and an accountability gap, which this research aims to address by providing considerations to overcome these challenges.

The thesis will focus exclusively on privately owned financial organizations and their respective responsibilities and will not examine national central banks or development banks. Furthermore, the analysis will generally refrain from addressing the human rights responsibilities of publicly owned financial organizations. Moreover, topics related to human rights concerns with investment agreements and human rights clauses as well as ICSID[58] arbitration in the dispute resolution context will not be examined. In addressing financial organizations this thesis adopts the term financial organizations covering a range of financial undertakings, hence the scope of financial organizations will be further elaborated in the first chapter. It also has implications for the financial advisors as well. Moreover, this thesis will provide some examples of national or European Union legislation for comparison purposes only. The case law covered will be related to the lack of compliance with soft law standards regarding human rights by financial organizations through selected procedures before NCPs under OECD, specific national litigation procedures, approaches regarding the ESG practices, as well as some information disclosures mainly within climate change information with limited human rights implications.[59] Additionally, this thesis will explore some of the practical examples of ESG approaches.

1.8. Roadmap to the Thesis

[58] *Convention on the Settlement of Investment Disputes between States and Nationals of Other States* (ICSID Convention), March 18, 1965, 575 U.N.T.S. 159.
[59] Javier Solana, "Climate Litigation in Financial Markets: A Typology," *Transnational Environmental Law* 9, no. 1 (March 2020): 103–35, https://doi.org/10.1017/S2047102519000244.

This thesis aims to explore to what extent and how financial organizations, should perform HRDD due diligence in investment services. In other words, what does the HRDD entail and what is the role of the financial organizations' HRDD responsibility, for their investment services to comply with human rights standards? Existing ESG practices will be evaluated as current approaches in investment activities, with a focus on their inconsistencies with human rights standards and specifically with the HRDD obligations. Moreover, the clarification is aimed to advance developed practices and provide greater alignment with human rights standards in finance.

The second chapter will analyze the growing responsibilities of financial organizations, particularly banks, to align investments with human rights principles, highlighting the need for an open-ended scope in the complex EU financial markets. It reviews historical human rights abuses by banks, such as US lending discrimination, and the challenges in implementing ethical practices within ESG investing. Recent claims against Swiss and UK banks illustrate the necessity of Human Rights Due Diligence (HRDD) and its implementation challenges. The chapter aims to clarify HRDD responsibilities for financial organizations and evaluate ESG practices to promote respect for human rights.

The third chapter will delve into the roadmap of Human Rights Due Diligence (HRDD) within the financial sector's investment landscape, focusing on the practical application and challenges under the UN Guiding Principles on Business and Human Rights (UNGPs) and OECD Guidelines. It will examine how financial organizations interpret and implement HRDD in their investment practices, addressing ambiguities and evolving standards. The chapter will explore the complexities of accountability, including the unique nature of financial relationships and the unclear role of HRDD in navigating direct linkages between investors and investee companies. It will analyze the implications of national laws and business initiatives on corporate responsibility, aiming to provide a nuanced understanding of how

HRDD can effectively guide financial institutions toward aligning their investment activities with human rights principles.

Chapter Four delves into the intricacies of Human Rights Due Diligence (HRDD) tailored for financial organizations, focusing on the first phase of HRDD in identifying and assessing human rights risks and their complexities, prioritization, and the actions taken to prevent and mitigate adverse human rights impacts. It highlights challenges such as differing interpretations of risk severity and ethical considerations in investor engagement with investee companies. Additionally, the chapter critiques Environmental, Social, and Governance (ESG) practices within HRDD, noting their fragmented approach to incorporating human rights factors ("S") into investment decisions. This fragmented approach can inadvertently lead to human rights violations. Moreover, reliance on self-reported ESG data introduces risks of inaccuracies and bias, potentially hindering effective HRDD. The chapter advocates for regulatory measures to align ESG practices with robust HRDD standards, ensuring financial organizations integrate human rights principles responsibly into their investment strategies.

Chapter Five analyzes the specific Human Rights Due Diligence (HRDD) obligations of financial organizations during the investment lifecycle focusing on their obligations under the UNGPs and OECD Guidelines. It examines how these entities navigate assessing their involvement in human rights impacts across different levels of causality—whether causing, contributing to, or being linked with harm. The chapter critically evaluates the challenges inherent in discerning these linkages within diverse corporate governance structures and ownership dynamics. Moreover, it aims to provide a comprehensive understanding of how financial organizations can fulfill their responsibilities to respect human rights throughout the investment lifecycle via robust HRDD practices. Additionally, the chapter explores leverage-based responsibility within HRDD, particularly pertinent when financial organizations hold minority shares in investee companies. Despite their limited ownership, these organizations are mandated to ensure their investments do not support human rights violations. This entails leveraging influence—beyond traditional voting rights—to mitigate and address human rights impacts arising from business relationships. Chapter Five indicates the evolving role of financial organizations in leveraging their influence through proactive engagement to align investments with human rights principles and sustainable development goals.

In conclusion, the thesis examines the challenges faced by financial organizations in implementing human rights due diligence (HRDD) under the UN Guiding Principles (UNGPs). Ambiguities persist regarding their responsibilities for human rights impacts arising from investments, emphasizing the need for coherent regulatory frameworks. Cases analyzed reveal gaps in compliance with soft law standards and complexities in corporate responsibilities. The thesis advocates for enhanced HRDD aligned with international guidelines to mitigate risks and promote ethical investing practices, urging transparency and accountability in financial operations.

2. Sope, historical context, and the importance of HRDD

2.1. Scope of the financial organizations

The scope of financial organizations addressed by this thesis will be delineated in an open-ended manner. The reason why will be clarified in the following paragraph.

The need for an open-ended scope is portrayed by the complexities and specificities of financial markets as well as other capital markets in the EU and creates a challenge to determine who are the main financial organizations addressed in this thesis. Although there were several attempts of the EU financial system to move from long and persistent bank-based finance, a system is still mainly construed around banks.[60] A shift in the financial system in the EU is happening, and these findings are part of that shift.

However, besides the ongoing evolution of the EU financial system into more market-based finance that is gaining prominence[61], banks still play a central role in the EU financial system and, thus remain as the main actors based on their influence on the market.

According to the EU Regulation No 575/2013[62] a range of financial institutions offer investment services within the EU and are defined, outlining their distinct roles and regulatory frameworks. Such a list of financial organizations covered by the Directive aligns with this

[60] Niamh Moloney, *EU Securities and Financial Markets Regulation*, Fourth Edition, New to this Edition:, Fourth Edition, New to this Edition:, Oxford European Union Law Library (Oxford, New York: Oxford University Press, 2023), 11.
[61] Moloney, 11.
[62] European Parliament, Council of the European Union. (2013). Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012. Official Journal of the European Union, L 176/1.

thesis and covers diverse actors from credit institutions and investment firms to insurance and reinsurance undertakings. Each entity plays a vital role within the broader financial landscape, ensuring adherence to regulatory standards and safeguarding investor interests.

More importantly, banks in the EU do offer some of those services as well. EU banks perform services such as investing advice, portfolio management, and underwriting and placing of financial instruments, for example, 'Erste Asset Management'[63]. That is why a bank, which has a crucial role in the EU financial market is considered as well under the term 'financial organization'.

On the contrary, investment banking, represents a distinct sector within the financial industry, separate from traditional banking practices in the US.[64] Originating from nineteenth-century finance houses, investment banking evolved to specialize in securities-related activities, such as underwriting, advisory services, and proprietary trading.[65] Unlike traditional EU banks, investment banks in US typically do not engage in deposit-taking or retail banking services. Instead, they rely on market timing and specialized fees to generate revenue, negotiating fees with clients based on the complexity and risk involved in transactions.[66] This contrasts with the deposit-based business model of traditional banks, such as in the EU, which serve a broader customer base and rely on interest spreads and fees from banking services. Hence, indicates that in the EU, traditional banks offer various activities and are the main actors within investment relationships, while in the US investment banks are not traditional banks in the EU sense.

[63] https://www.erste-am.at/en/private-investors, accessed on 08.06.2024.
[64] Charles R. Geisst, "Investment Banking," in *A Guide to Financial Institutions*, ed. Charles R. Geisst (London: Palgrave Macmillan UK, 1988), 50–51, https://doi.org/10.1007/978-1-349-18807-9_4.
[65] Geisst, 51.
[66] Geisst, 51.

This thesis adopts the term "financial organization" to encompass a variety of financial actors, reflecting the diverse drivers of financial markets in different systems. While the focus indirectly includes banks, which play a significant role in investment activities within the EU, the thesis also addresses various other financial actors.

This thesis extends beyond specific financial and capital market actors such as banks. While banks are extensively discussed in the literature due to their pivotal role in the financial market, the findings also apply to a broader array of actors involved in investment relationships. That may be seen in an example of the capital-raising process. For instance, from the underwriting process and actors, that are subject to specific forms of EU financial markets regulation, to subjects such as investment firms, which are under specific conduct and prudential requirements, as well as to market intermediaries that support capital raising and often are governed by the market abuse regimes.[67] For instance, underwriters assess and manage the risk of new issues. Most importantly, as the financial system of the EU is based around banks, banks are considered as main actors in the financial systems. Contrarily, these dynamic as expressed previously are not construed similarly in the US.

The topic is crucial as it ensures that capital mobilization into climate action investments, such as renewable energy projects, prioritizes safeguarding human rights, encapsulated by the concept of 'just transition'. Thus, ‘Just transition’ entails a comprehensive and equitable shift from a high-carbon to a low-carbon economy, aiming to significantly reduce greenhouse gas emissions while preserving dignified livelihoods, especially for vulnerable communities.[68] Moreover, the importance of ‘just transition’ regarding human rights considerations in ESG investing was emphasized by the Grantham Institute on Climate Change

[67] Moloney, *EU Securities and Financial Markets Regulation*, 67.
[68] Stark, Gale, and Murphy-Gregory, 1278–93.

and the Environment[69] at LSE in their Submission[70] to the UN Working Group on business and human rights.

2.2. Historical Context and current issues

As mentioned, Lending Discrimination Practices in the US, revealed how banks based their credit decisions on factors other than the applicant's creditworthiness, denying services to the applicants being residents of specific neighborhoods due to their race or ethnicity. These practices, rooted in systemic racism, systematically disadvantaged Black communities by restricting access to housing loans and perpetuating racial segregation, gravely affecting their human rights.[71]

However, the interplay between the activities of specific financial organizations, such as investment services, and human rights abuses remains challenging and largely unexplored.[72] One of the primary reasons for that was the prevailing notion that its impact was largely indirect.[73]

Therefore, the primary reason for this exclusion was the prevailing notion that the financial sector's impact on human rights was largely indirect.[74] Insufficient awareness of the financial industry's role in adverse impacts has limited visibility for victims of human rights abuses. However, the emergence of ESG investing signals growing recognition that adopting

[69] https://www.lse.ac.uk/granthaminstitute/ , accessed on 10.06.2024.
[70] Higham, Catherine, Ian Higham, Sangeeth Raja Selvaraju, and Brendan Curran. "Submission to the UN Working Group on Business and Human Rights Inquiry on Investors, ESG, and Human Rights: Consultation Response." October 2023., accessed on 09.06.2024.
[71] Banaji, Fiske, and Massey, 5–7.
[72] Deva et al., "Editorial," 206–8.
[73] Deva et al., 207–8.
[74] Deva et al., 207–8.

ethical principles not only enhance ethical considerations but also safeguard the financial sector's reputation.[75] Nonetheless, within ESG investing, human rights issues are categorized under 'S' (Social), which remains the least developed and faces numerous challenges.[76] Furthermore, challenges such as a heavy emphasis on short-term financial gains, shareholder primacy and the absence of standardized ESG data, particularly in the social sphere, undermined the implementation of ethical practices and the promotion of human rights.[77]

The 1930 debate between Berle and Dodd initially addressed a fundamental divergence in corporate responsibility regarding adverse impacts, with Berle emphasizing shareholder primacy and asserting that corporations' powers should exclusively benefit shareholders.[78] In contrast, Dodd's perspective supported a broader responsibility of directors towards not only shareholders but also the general public and affected communities, reflecting a more inclusive approach to corporate governance and responsibility.[79]

Following that, the absence of the financial organization's human rights responsibility was to a certain extent inflected by the lack of their appropriate inclusion in the initial framework of the UNGPs, having in mind that the respective standards are primarily focused on conventional industrial enterprises.[80] Similarly, the specificity of the relationship between the investor and the investee company was emphasized in the OECD Guidelines on Responsible

[75] Glenn Fitzpatrick, Jonathan Neilan, and Peter Reilly, "Time to Rethink the S in ESG," *The Harvard Law School Forum on Corporate Governance* (blog), June 28, 2020, https://corpgov.law.harvard.edu/2020/06/28/time-to-rethink-the-s-in-esg/.
[76] Fitzpatrick, Neilan, and Reilly, "Time to Rethink the S in ESG."
[77] John Gerard Ruggie and Emily K. Middleton, "Money, Millennials and Human Rights: Sustaining 'Sustainable Investing,'" *Global Policy* 10, no. 1 (2019): 144–45, https://doi.org/10.1111/1758-5899.12645.
[78] Julia Ruth-Maria Wetzel, "Corporations and Human Rights," in *Human Rights in Transnational Business: Translating Human Rights Obligations into Compliance Procedures*, ed. Julia Ruth-Maria Wetzel (Cham: Springer International Publishing, 2016), 81–82, https://doi.org/10.1007/978-3-319-31325-2_4.
[79] Wetzel, 81–82.
[80] Regis Bismuth, "The Emerging Human Rights and Environmental Due Diligence Responsibility of Financial Institutions," SSRN Scholarly Paper (Rochester, NY, May 1, 2023), 12–14, https://papers.ssrn.com/abstract=4435483.

Business Conduct for Institutional Investors[81] stating that their relationship is qualitatively different from the relationship between purchaser and supplier companies, which resembles the most common business relationships. As an already recognized issue, the core reason behind the impression of 'indirect effects' of financial organizations is the investment relationship that has "no direct operational or contractual ties"[82], nevertheless an investor can influence the behavior of an investee company, through its services, especially in ownership.[83]

Such neglect of financial organizations leaves a gap in exploration, recognized by the mentioned UN working group, and is enabling financial organizations to disregard human rights concerns as well as narrowly interpret their due diligence obligations.[84]

This was supported by the latest Banktrack report from 2022, noting that none of the 50 banks researched have adequately implemented the UN Guiding Principles on Business and Human Rights, with most scoring less than half of the expected criteria.[85] Even more, a persistent gap in meeting these minimum expectations was identified.

2.3. The Critical Role of HRDD in Financial Investments

Recently, in 2023 several NGOs filed claims alleging that Swiss and UK banks invested in companies that are causing ongoing human rights violations against migrants and others

[81] OECD (2017), Responsible business conduct for institutional investors: Key considerations for due diligence under the OECD Guidelines for Multinational Enterprises.
[82] Ibid. 7.
[83] Ibid. 7.
[84] Bismuth, "The Emerging Human Rights and Environmental Due Diligence Responsibility of Financial Institutions," 14.
[85] The BankTrack Global Human Rights Benchmark 2022, Published 17th November 2022, Banktrack, https://www.banktrack.org/download/global_human_rights_benchmark_2022/global_human_rights_benchmark_2022_2.pdf

detained in companies' immigration detention facilities.[86] The alleged abuses by investee companies ranged from forced labor, threats of punishment including solitary confinement and physical restraint, as well as deprivation of basic needs, and interference with legal rights. On the same note, yet another case was previously filed, claiming that Norges Bank Investment Management (NBIM) has failed to exercise HRDD or use its leverage regarding its investments in McDonald's concerning the ongoing gender-based violence and harassment documented throughout its franchises in several countries, globally.[87]

Both of these cases were submitted to National Contact Points (NCP) in Countries that are members of the Organization for Economic Cooperation and Development (OECD), established to monitor the implementation of the OECD guidelines regarding responsible business conduct.[88] These NCPs are national independent quasi-judicial bodies established to mediate between companies and victims of human rights abuses, interpreting OECD guidelines and promoting responsible business, though lacking enforceable judgment powers.[89]

The cases referenced illustrate whether financial organizations comply with soft law standards of responsible conduct, particularly concerning their failure to conduct adequate HRDD across all relevant aspects and to leverage their influence as investors to fulfill their expected responsibility to respect human rights. Specifically, claimants argued that respondent

[86] Complaints to the Swiss and United Kingdom National Contact Points under the Specific Instance Procedure of the 2023 OECD Guidelines for Multinational Enterprises, claimants: BankTrack, Coalition for Immigrant Freedom and Worth Rises, respondents: Swiss National Bank, UBS, Barclays and HSBC, filed on January 16th, 2024.https://www.banktrack.org/download/complaints_to_the_swiss_and_united_kingdom_national_contact_points_under_the_specific_instance_procedure_of_the_2023_oecd_guidelines_for_multinational_enterprises/complaints_re_breaches_of_the_oecd_guidelines_by_barclays_hsbc_swiss_national_bank_and_ubs_1_names_redacted.pdf , accessed on 08.06.2024.

[87] Complaint to the Norwegian National Contact Point for Responsible Business Conduct, claimants: IUF, EFFAT-IUF and UGT, respondent: Norges Bank Investment Management (NBIM), complaint filed on May 18th 2020. https://files.nettsteder.regjeringen.no/wpuploads01/sites/263/2021/06/Initial-assessment-for-publication-21-June-2021.pdf , accessed on 08.06.2024.

[88] Karin Buhmann, "Analysing OECD National Contact Point Statements for Guidance on Human Rights Due Diligence: Method, Findings and Outlook," *Nordic Journal of Human Rights* 36, no. 4 (October 2, 2018): 393–94, https://doi.org/10.1080/18918131.2018.1547526.

[89] Buhmann, "Analysing OECD National Contact Point Statements for Guidance on Human Rights Due Diligence," 395.

Banks failed to respect human rights, and requested that they should be urged to be transparent about their connections with investee companies, conduct thorough human rights due diligence, and use their influence to address any impacts. Furthermore, complaints requested that if necessary, banks should divest and establish clear policies for similar cases.

Therefore, these examined issues highlight the critical importance of HRDD for financial organizations in ensuring they uphold human rights, yet uncertainties persist regarding its role and implementation. The importance of HRDD was also recognized through attempts to implement it via the US Foreign Corrupt Practices Act, expanding corporate obligations toward human rights.[90]

One of the primary reasons for the inefficient implementation of HRDD is the lack of clarity regarding its role and scope, particularly within financial organizations when addressing investment practices and human rights impacts on investee companies.[91]

Thus, the central focus of this research is to examine the role and scope of HRDD in ensuring that financial organizations adhere to their human rights obligations. This entails delineating the parameters that determine when financial organizations should be responsible for human rights violations according to adopted international soft law standards. Additionally, according to soft law standards, investors may need to publicly demonstrate a diverse range of activities to meet expected human rights standards.

[90] Rachel Chambers and Jena Martin, "Reimagining Corporate Accountability: Moving Beyond Human Rights Due Diligence," SSRN Scholarly Paper (Rochester, NY, May 12, 2021), 815–17, https://doi.org/10.2139/ssrn.3852975.

[91] Jonathan Bonnitcha and Robert McCorquodale, "The Concept of 'Due Diligence' in the UN Guiding Principles on Business and Human Rights," *European Journal of International Law* 28, no. 3 (November 13, 2017): 904–6, https://doi.org/10.1093/ejil/chx042.

Existing ESG practices will be evaluated as ethical frameworks in investment activities to promote respect for human rights. The thesis will critically examine how these practices align with HRDD (Human Rights Due Diligence) obligations in finance.

The following analysis is important considering the ongoing broader debate[92] on the scope of HRDD responsibility for banks and other financial organizations to comply with human rights standards, delivered by different bodies, such as the UN bodies, OECD NCPs, and developed business-led approaches. This debate is interchangeably linked as well to the question of the role of the HRDD.

[92] Bismuth, "The Emerging Human Rights and Environmental Due Diligence Responsibility of Financial Institutions," 12.

3. Application of UNGPs and OECD Guidelines to the financial sector in investing

3.1. Application and specific financial business relationship

This chapter will examine the general application of UNGPs and OECD Guidelines in the investment context as well as the role HRDD has regarding financial organizations' responsibility to respect human rights, indicating the specific interpretations as well as the inherent ambiguities of the HRDD and its role.

The finance industry's unique business relationships and services have led to ambiguity regarding their complicity in human rights standards.[93] As previously mentioned unique nature of the investment relationship poses challenges for effective supervision and regulation, which not only affects market stability but also complicates ensuring human rights standards within financial practices.[94] To address these challenges, various soft-law guidelines and specific interpretations have emerged to enhance their application in investment services.

As indicated, the financial organizations were left in "a blind spot"[95] under UNGPs. That neglect of financial organizations led to the different interpretations of HRDD for financial

[93] Christine Kaufmann, "Respecting Human Rights in Investment Banking: A Change in Paradigm," in *Responsible Investment Banking: Risk Management Frameworks, Sustainable Financial Innovation and Softlaw Standards*, ed. Karen Wendt (Cham: Springer International Publishing, 2015), 510, https://doi.org/10.1007/978-3-319-10311-2_34.
[94] Kaufmann, 510.
[95] Bismuth, "The Emerging Human Rights and Environmental Due Diligence Responsibility of Financial Institutions," 13.

organizations by the industry itself resulting in their lack of compliance with human rights responsibilities.[96]

For this reason, the application of UNGPs was previously challenged by financial organizations and banks, especially in investing, questioning to what extent and how their investment services are addressed in two core soft law standards, namely the UNGPs and OECD Guidelines, as the two most authoritative global frameworks that directly address corporations' expected obligations regarding human rights.

Furthermore, provided standards were challenged specifically questioning how investment activities, as financial services, with the investee companies' human rights harm, as a third-party responsibility, affect the financial organization's compliance with the respective guidelines.

The crucial legal sources are the UNGPs, which are based on three pillars of safeguarding human rights. They define (1) state obligations to respect, protect, and fulfill human rights and fundamental freedoms, (2) business obligations to respect human rights, and (3) the processes to advance the access or remedy for business-related human rights abuses which address both state and businesses. Moreover, the main focus of this thesis is the second pillar concerning the obligation of businesses, specifically financial organizations, to respect human rights.

Under the second pillar, the UNGPs set operational principles that elaborate on the "policies and processes businesses need to have in place to ensure that they respect human rights"[97]. According to the UNGPs Principle 2 companies should not be complicit with human

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[96] Thun Group of Banks, Paper on the Implications of UN Guiding Principles 13b & 17 in a corporate and investment banking context, December 2017, https://media.business-humanrights.org/media/documents/files/documents/2017_12_Thun_Group_of_Banks_Paper_UNGPs_13b_and_17.pdf , accessed on 10.06.2024.
[97] Interpretative Guide on United Nations Guiding Principles on Business and Human Rights, 4.

rights. Complicity refers to a company's involvement, either through action or omission, in furthering or benefiting from human rights abuses committed by others, or its failure to prevent such abuses despite having the capacity to do so.[98] The UNGPs Principle 21 stipulates for businesses to meet their expected responsibility to respect human rights should put in place a policy commitment to respect human rights, conduct human rights due diligence and enable the remediation of any adverse human rights impacts.[99] Moreover, the UNGPs Principle 11 defines that businesses must respect human rights by 'avoiding infringement and addressing adverse impacts with which they are involved in'[100] for which HRDD is a crucial tool. Therefore, it is significant to highlight that UNGPs emphasize the importance of the prevention of human rights abuses, thus, focusing rather on preventing human rights infringements and highlighting that positive actions cannot compensate for human rights harm.[101] Therefore, companies should prioritize preventing human rights harm, and positive commendable activities by companies cannot excuse them for failure to do so.[102]

In essence, policy commitment, HRDD, and remediation form a comprehensive toolbox for businesses and financial organizations to meet their obligations under the UNGPs and prevent human rights abuses.

In detail, "due diligence is understood as the process through which enterprises can identify, prevent, mitigate and account for how they address their actual and potential adverse

[98] Wetzel, "Business and Human Rights at the UN," 156–57.
[99] UN Guiding Principles on Business and Human Rights. (2011). Principle 21: Business enterprises should respect human rights. This means that they should avoid infringing on the human rights of others and should address adverse human rights impacts with which they are involved.
[100] UN Guiding Principles on Business and Human Rights. (2011). Principle 11: Business enterprises should respect human rights. This means that they should avoid infringing on the human rights of others and should address adverse human rights impacts with which they are involved.
[101] Radu Mares, "Securing Human Rights through Risk-Management Methods: Breakthrough or Misalignment?," *Leiden Journal of International Law* 32, no. 3 (September 2019): 525–27, https://doi.org/10.1017/S0922156519000244.
[102] Mares, 525–27.

impacts as an integral part of business decision-making and risk management"[103]. Even the interpretations delivered later on insufficiently explored the different roles that HRDD can have for a business to meet its expected responsibility to respect human rights[104] as scholars recognized that the dual nature of the HRDD process remained unexplained.

However, it is important to highlight that HRDD is not entirely similar to the notion of due diligence in business.[105] Business due diligence focuses on risks to the business, while HRDD addresses risks to individuals affected by business activities.[106] HRDD involves multiple responsibilities for a company's own impacts and those of its business partners, varying in complexity with business size, risk severity, and context.[107]

The stipulated responsibilities apply to the conduct of all business sectors generally. As it was previously stated, the position of the financial sector, especially in investing, is to a certain degree challenging compared to other industry sectors.[108] Thus, combining the uniqueness of business relationships in investing with the unclear role of the HRDD and the initial lack of appreciation towards the financial sector, making it even more challenging to comprehend what financial organizations' responsibility to respect human rights entails.

For that reason, interpretations by the Office of the UN High Commissioner of Human Rights (OHCHR) regarding the application of UNGPs emerged. Consequently, interpretations by NCPs regarding the application of the OECD Guidelines were given to clarify the applicability of these standards to a relationship between investors and investee companies,

[103] OECD Guidelines for Multinational Enterprises (2011), Commentary on General Policies, paragraph 14.
[104] Bonnitcha and McCorquodale, "The Concept of 'Due Diligence' in the UN Guiding Principles on Business and Human Rights," 910.
[105] Robert McCorquodale and Daria Davitti, "Human Rights Due Diligence," in *Teaching Business and Human Rights* (Edward Elgar Publishing, 2023), 102–3, https://www.elgaronline.com/edcollchap/book/9781802201130/book-part-9781802201130-18.xml.
[106] McCorquodale and Davitti, 102.
[107] McCorquodale and Davitti, 102.
[108] Kaufmann, "Respecting Human Rights in Investment Banking," 510.

simultaneously delivering specific guides to ensure financial organizations in investing fulfill their obligation to respect human rights.

Regarding the application of UNGPs to the financial sector in investing, several documents were issued delivering the interpretation and application of UNGPs to the financial sector, specifically in investment services from 2013 onwards. Even the Interpretative Guide[109] for the UNPGs did not offer sufficient clarification on the implementation of UNGPs to the finance industry published in 2012. Therefore, besides the initial UNGPs and the Interpretative guide, the Office of the High Commissioner issued clarifications for investment services, among the most important were the first Response[110] from April 2013, the second Response[111] from November 2013, lastly regarding the application of UNGPs towards banks specifically in the Response[112] from June 2017 concerning the application of UNGPS in the finance industry.

A decade after the adoption of the UNGPs and its interpretation, utilization of investors in safeguarding human rights remained scarce, hence the UN published the document Taking Stock of Investor Implementation of the UN Guiding Principles on Business and Human Rights[113] to advance more respect for human rights in investment services.

Simultaneously, OECD Guidelines for Multinational Enterprises, aligned with UNGPs, were interpreted as well by two additional guides, namely the OECD Guide for Institutional

[109] An interpretative guide – "The corporate responsibility to respect human rights' New York and Geneva 2012, UN.
[110] OHCHR – Subject: The issue of the applicability of the Guiding principles on business and human rights to minority shareholdings, Office of the High Commissioner of the UN, Geneva, 26 April 2013.
[111] OHCHR – Subject: Request from the Chair of the OECD Working party on Responsible business conduct, Office of the High Commissioner of the UN, Geneva, 27. November 2013.
[112] OHCHR Response to Request from BankTrack for Advice Regarding the Application of the UNG Guiding Principles on Business and Human Rights in the Context of the Banking sector, Office of the High Commissioner of the UN, Geneva 12 June 2017.
[113] UN Working Group on Business and Human Rights, 'Taking stock of investor implementation of the UN Guiding Principles on Business and Human Rights', Adendum report of the Working Group on the issue of human rights and transnational corporations and other business enterprises, Geneva, June 2021 A/HRC/47/39/Add.2.

Investors[114] and the OECD Guide on Due Diligence for Responsible Corporate Lending and Securities Underwriting[115] as a guide for responsible business conduct in investing. Both of these sets of interpretive documents together form a part of the responsible conduct defining what entails the financial origination's responsibility to respect human rights.

Among the financial sector's uncertainties was how financial organizations' responsibility to respect human rights in their investments aligns with the scope of UNGPs. The OHCHR stated since 2013 that investors' relationship with investee companies forms a "business relationship" under the UNGPs and therefore falls under its scope. Moreover, the term "business relationship" is a non-exhaustive list, and can be interpreted to different business setups. Such a position was clarified by the interpretative guide[116] of the UNPGs as well as in the official letter of the OHCHR[117] indicating that the UNGPs apply to both majority and minority shareholders regarding institutional investors' responsibility to respect human rights.

Financial organizations are now expected to integrate the activities of their business partners and clients into their due diligence processes to prevent complicity in human rights abuses, even if they cannot directly attribute adverse human rights impacts to themselves.[118]

Furthermore, it was emphasized by the OCED Guide for Institutional Investors that it is important for the list to remain open-ended and yet with a determinable scope in any given case,

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[114] OECD (2017) Responsible business conduct for institutional investors: Key considerations for due diligence under the OECD Guidelines for Multinational Enterprises

[115] OECD (2019), Due Diligence for Responsible Corporate Lending and Securities Underwriting: Key considerations for banks implementing the OECD Guidelines for Multinational Enterprises.

[116] OHCHR, The Corporate Responsibility to Respect Human Rights: An Interpretive Guide (2012). The Guide was issued to provide additional background explanation of the Guiding Principles to support a full understanding of their meaning and intent. The Guide's content was the subject of numerous consultations during the mandate of the former Special Representative of the Secretary-General on the issue of human rights and transnational corporations and other business enterprises

[117] Applicability of the UNGPs to Minority Shareholdings of Institutional Investors," letter to Joris Oldenziel from Office of the High Commissioner for Human Rights, April 26, 2013, accessed June 15, 2024 h.ttps://www.ohchr.org/sites/default/files/Documents/Issues/Business/LetterSOMO.pdf.

[118] Kaufmann, "Respecting Human Rights in Investment Banking," 513–14.

before NCPs, due to the need to offer adequate efficacy in a rapidly changing business world.[119] This leaves the scope of the "business relationship" to be open-ended, not limited by a specific sector and applicable to different types of companies or business relationships.[120] It is quite valuable due to the shifting nature and diverse trends in the financial industry.

It is significant to highlight that not only UNGPs apply to financial organizations as investors but also that the percentage of the ownership does not limit or exclude the application of both the UNGPs and OECD guidelines. In detail, this means that "investors, even those with minority shareholdings, may be directly linked to adverse impacts caused or contributed to by investee companies as a result of their ownership in, or managing of shares in the company causing or contributing to certain social or environmental impacts."[121]. Moreover, this interpretation clarified that both soft law standards apply to cases when an investor has its shares or manages them for the benefit of others as underwriters as well as to all investors regardless of their size, location, ownership or structure.

However, opposition to applying human rights due diligence (HRDD) to banks received disagreements. The reason for it is around several key arguments.[122] Arguments that such application is inherently challenging. Critics contend that human rights issues in banking services often result from indirect client activities, making it difficult for banks to establish direct accountability.[123] Among some of them, important criticism is concerned with the intricate task of defining complicity in adverse human rights impacts, alongside the practical difficulties of demonstrating due diligence while upholding client confidentiality.[124] Primarily,

[119] OECD (2017) Responsible business conduct for institutional investors: Key considerations for due diligence under the OECD Guidelines for Multinational Enterprises, 14.
[120] Ibid. 14.
[121] Ibid. 13.
[122] Damiano de Felice, "Banks and Human Rights Due Diligence: A Critical Analysis of the Thun Group's Discussion Paper on the UN Guiding Principles on Business and Human Rights," SSRN Scholarly Paper (Rochester, NY, 2015), 12–14, https://doi.org/10.2139/ssrn.2477126.
[123] de Felice, 13–14.
[124] de Felice, 14–15.

the issue revolved around the responsibility for human rights violations caused by the investee company.

However, according to the given interpretations the positions that investors have within the investee companies, whether majority or minority shareholders, represent a key factor in determining what should investors do upon identifying negative human rights impacts. Furthermore, this clarification suggests that risks to human rights within investors' portfolios, stemming from their financial activities in various contexts, may be directly linked with human rights violations of the investee companies.[125]

It is important to highlight, as from the OCHR Response from June 2017 that a bank's actions in the financial relationship context include financial organizations' actions or decisions (including the emissions as well) involving third parties such as providing financial products or services.[126] Due to the specificities inherent in owning or managing shares in the investee company, particularly within the realm of corporate governance dynamics, financial organizations may inadvertently contribute to or become linked with instances of human rights harm. And this obligation to respect extends from before investment and during the lifecycle of the investment.

However, decisive factors that determine the level of linkage with human rights harm will be analyzed in the following chapters. The OECD Guidelines offer important decisive factors which that be broadly considered as policy-mandate-based, control and leverage-based, screening and selection-based, collaborative and participatory, strategic and long term, and engagement and improvement which may help determinate the linkage.

[125] OECD (2017) Responsible business conduct for institutional investors: Key considerations for due diligence under the OECD Guidelines for Multinational Enterprises 13.
[126] OHCHR Response to Request from BankTrack for Advice Regarding the Application of the UNG Guiding Principles on Business and Human Rights in the Context of the Banking sector, Office of the High Commissioner of the UN, Geneva 12 June 2017.

Following that provided interpretations clarified that financial originations' responsibility is not construed to undermine or shift the responsibility from the investee company that caused human rights harm towards the investors or financial organizations.

However, regardless of the struggle around the uniqueness of the relationship in investing the unclear role of the HRDD may challenge the implementation of the UNGPs, which will be examined in the following chapter.

3.2 The ambiguity of the role of the HRDD and scope of accountability

As the struggle from the financial sector emerged, the question appeared on the exact definition and extent of the defined HRDD concerning financial organization's expected responsibility.

The exact definition of what HRDD entails is still considered lacking.[127] The main purpose of the inclusion of such processes is not to limit the initial company's accountability for human rights harm, but to put in place a process to enable the companies to be able to "show to any external regulator or court that it has done everything reasonable that it could have done, should an adverse impact occur."[128] However, even if it manages to adequately show its findings the question of responsibility is not resolved.

From one side, HRDD has the role of proactive risk management tool for continuous improvement in managing human rights risks across business operations[129], which is aligned with the idea of investors that have resisted HRDD responsibilities, claiming that they are

[127] McCORQUODALE et al., "Human Rights Due Diligence in Law and Practice," 198.
[128] McCORQUODALE et al., 199.
[129] Bonnitcha and McCorquodale, "The Concept of 'Due Diligence' in the UN Guiding Principles on Business and Human Rights," 908–11.

burdensome and not universally applicable to all business sectors.[130] Thus, companies by adopting the HRDD prove sufficiently that they respect human rights.[131] As mentioned, financial organizations as investors argued against the responsibility for human rights harm apart from their own services, thus undermining their direct linkage with investee companies' human rights harm in favor of HRDD as an internal business process.

On the other hand, the second role of putting in place the HRDD process indicates how financial organization deals with human rights risks connected with their investments, which is a part of the standard of conduct HRDD of financial institutions in investing, regardless of the level of linkage with the human rights risks or impacts.[132] Moreover, the second role is construed to assist financial organizations in showing how they address human rights harm caused by investee companies, and meet their responsibility to respect human rights., but the process itself does not lift the responsibility for the harm of the investee company.

Therefore, the ongoing scholarly debate focuses on whether a company's responsibility to address human rights impacts should hinge on its degree of involvement in causing or contributing to those harms.[133] Thus, leaving the debate on the question of whether HRDD should serve as a complete defense against liability or if compliance with HRDD alone is insufficient requiring legal liability hindered the UNGPs application to the financial sector.[134]

[130] Surya Deva and David Birchall, eds., "Human Rights Due Diligence in Theory and Practice, Mark B. Taylor," in *Research Handbook on Human Rights and Business*, Research Handbooks in Human Rights (Northampton: Edward Elgar Publishing, 2020), 104.
[131] Bonnitcha and McCorquodale, "The Concept of 'Due Diligence' in the UN Guiding Principles on Business and Human Rights," 910.
[132] Bonnitcha and McCorquodale, 909–11.
[133] John Gerard Ruggie and John F Sherman, "The Concept of 'Due Diligence' in the UN Guiding Principles on Business and Human Rights: A Reply to Jonathan Bonnitcha and Robert McCorquodale," *European Journal of International Law* 28, no. 3 (November 13, 2017): 926–28, https://doi.org/10.1093/ejil/chx047.
[134] Robert McCorquodale and Cristina Blanco-Vizarreta, "Guiding Principle 17: Human Rights Due Diligence," in *The UN Guiding Principles on Business and Human Rights* (Edward Elgar Publishing, 2023), 17, https://www.elgaronline.com/edcollchap/book/9781800375673/book-part-9781800375673-28.xml.

This debate highlights differing perspectives on the extent of corporate accountability for human rights violations and the role of due diligence in shaping corporate responsibility frameworks. Therefore, the question of whether the company should have foreseen a human rights impact and accounted for it regardless of the conducted HRDD and its involvement with it is not answered. Uncertainties like this leave the opportunity for diverse financial organizations to interpret their expected responsibility to respect human rights differently.[135]

Bonnitcha and McCorquodale argue that a company's obligation for remediation should be proportional to its degree of culpability, as determined through the due diligence process. Conversely, critics argue that human rights due diligence, while essential for risk identification, does not absolve a company of its responsibility to remedy human rights abuses, regardless of its level of involvement.

This debate was further portrayed in the adoption of national mandatory due diligence laws in Europe. The distinction is seen in the French Duty of Vigilance and the German Act on Corporate Due Diligence in Supply Chains.[136] The French law allows affected individuals to seek damages in court for non-compliance with due diligence, while the German law relies on administrative fines, offering less direct recourse for compensation.[137]

Consequently, a business-led initiative, known as Thun Group of Banks, engaged in the question of the application of UNPGs to the financial sector, especially towards banks, and provided a narrower interpretation of obligation under UNGPs.[138] This interpretation exacerbates existing ambiguity surrounding the obligations of financial organizations under the

[135] Bismuth, “The Emerging Human Rights and Environmental Due Diligence Responsibility of Financial Institutions,” 12.
[136] “Chapter 11: Mandatory Human Rights Due Diligence in: Teaching Business and Human Rights,” 145–51, accessed June 15, 2024, https://www.elgaronline.com/edcollchap/book/9781802201130/book-part-9781802201130-22.xml.
[137] “Chapter 11: Mandatory Human Rights Due Diligence in: Teaching Business and Human Rights,” 145–51.
[138] de Felice, “Banks and Human Rights Due Diligence,” 4–7.

United Nations Guiding Principles (UNGPs). Among the main arguments supporting this interpretation is the understanding that the role of HRDD is just one aspect of its function, undermining the responsibility for the investee company's human rights impacts.

However, businesses are obligated to uphold human rights across all their activities, which includes their own operations, those of their subsidiaries, and activities within their business relationships (such as suppliers and partners).[139] Yet, the accountability of financial organizations under HRDD remains a pertinent issue, regardless of the extent to which the HRDD process is conducted. Moreover, this indicates the expectation that financial organizations as an investor should address the negative impacts of the investee company regardless of their own impacts.

In sum, the HRDD entails the recognized the dual role of expected code of conduct as an ongoing process on how financial organization respects human rights as well as an internal process that should be put in place to avoid human rights harm that financial organizations may cause directly and account for if it occurs. Thus, HRDD entails both a rigorous risk management process and a standard of conduct that are essential for fulfilling obligations responsibly.[140] However, this debate was to some extent a key challenge for implementing the HRDD to financial organizations concerning their investee companies' human rights impacts, as financial organizations advocated only for one HRDD role.

Also, without performing human rights due diligence, companies cannot recognize or prove their respect for human rights, rendering any claims of upholding them unconvincing.[141]

[139] Robert McCorquodale and Justine Nolan, "The Effectiveness of Human Rights Due Diligence for Preventing Business Human Rights Abuses," *Netherlands International Law Review* 68, no. 3 (December 1, 2021): 459, https://doi.org/10.1007/s40802-021-00201-x.
[140] Andreas Rasche and Sandra Waddock, "The UN Guiding Principles on Business and Human Rights: Implications for Corporate Social Responsibility Research," *Business and Human Rights Journal* 6, no. 2 (June 2021): 236–37, https://doi.org/10.1017/bhj.2021.2.
[141] Ruggie and Sherman, "The Concept of 'Due Diligence' in the UN Guiding Principles on Business and Human Rights," 924.

Scholars argued that it is important to highlight that the concept of due diligence, understood as the level of conduct necessary to fulfill an obligation, has its origins in Roman law.[142] This argument in the debate uses the HRDD as an objective standard of expected conduct to assess a defendant's actions against an external benchmark of expected behavior, rather than their intentions or motivations.

As demonstrated by the initial case studies, there is a significant gap in the implementation and effective application of the UNGPs and OECD Guidelines by financial organizations. Many that many financial organizations are not publicly disclosing their HRDD assessments which are preconditions to show that they address the human rights impacts of their portfolios or investments and, thus do not fulfill the expected conduct. Without adequate HRDD financial organizations are not in a position to evaluate their own level of linkage to human rights harm, which will be elaborated in the following paragraph. This may be seen by the lack of cases as well as the lack of publicly disclosing findings.

The confusion over HRDD's role and the failure to meet expected standards undermine human rights protection, highlighting a potential need for mandatory regulations and clearer compliance mechanisms. In finance, unique business relationships and HRDD's unclear role pose challenges, particularly in cases where investors are directly linked to investee companies. This thesis will delve deeper into HRDD's integral parts in investment contexts in subsequent chapters.

[142] Ruggie and Sherman, 902.

4. Human Rights Due Diligence (HRDD) for Financial Organizations

After a decade of the UNGPs adoption, the UN working group delivered the Report[143] clarifying what 'rights-respecting investment' entails. The UN report focuses on several key elements and indicates specific gaps.

Aligned with recommendations from a comprehensive report, 'rights-respecting investing' involves several key obligations. This includes establishing a strong policy commitment to internationally recognized human rights, endorsed at the highest levels of institutional governance, and communicated publicly. Throughout the investment lifecycle, rigorous human rights due diligence is crucial to identify and address risks, going beyond traditional screens to focus on real-world impacts on individuals and communities. Investors must take decisive action to prevent and mitigate human rights harms, engaging with investee companies and stakeholders. Transparency is vital, with detailed progress tracking and public disclosure to ensure accountability. Effective grievance mechanisms and proactive stakeholder engagement further demonstrate commitment to remedy and address concerns, as highlighted by the UN Report on financial organizations' responsibilities regarding human rights.

[143] Human Rights Council Forty-seventh session 21 June–9 July 2021 Agenda item 3 Promotion and protection of all human rights, civil, political, economic, social and cultural rights, including the right to development, Report of the Working Group on the issue of human rights and transnational corporations and other business enterprises*, 17 June 2021, A/HRC/47/39/Add.1, https://documents.un.org/doc/undoc/gen/g21/151/67/pdf/g2115167.pdf?token=ONAetGs1O1n10Twa7x&fe=true

Despite the previously noted ambiguity surrounding the role of Human Rights Due Diligence (HRDD), the process itself is intricate, and forthcoming chapters will delve into additional aspects of it.[144]

The most significant element for this research is a process of human rights due diligence (HRDD) within which the risk assessment, identification of the level of causality, and acting upon findings with the usage of financial organizations' leverage would be further examined.

Therefore, the following chapters will separately examine the distinct parts of the HRDD process before and during the investment lifecycle.

4.1 Importance of HRDD in Identifying and Addressing Human Rights Risks

The first part of the envisaged obligation for financial organizations to respect human rights in investing should be to identify and assess real and potential adverse human rights impacts across investment activities and business relationships. Corporations must tailor their assessments to the industry, scale of operations, and expert insights to refine their strategies and prevent human rights impacts.[145] This is intrinsically linked with the importance of prevention of human rights abuses, thus assisting companies to prevent human rights harm.[146] The UN Framework and the UNGPs established human rights impact assessments as a cornerstone of the initial stage in the human rights due diligence process for companies, enabling them to

[144] Bonnitcha and McCorquodale, "The Concept of 'Due Diligence' in the UN Guiding Principles on Business and Human Rights," 900.
[145] Wetzel, "Business and Human Rights at the UN," 154.
[146] McCorquodale and Nolan, "The Effectiveness of Human Rights Due Diligence for Preventing Business Human Rights Abuses," 456.

identify and understand the potential impacts of their existing and proposed projects or activities on human rights.[147]

Moreover, the risk-based approach for financial organizations developed by the UNGPs should be construed to identify risks for people and not for financial returns, focusing on the human rights risks that are the most severe. According to this risk-based approach, investors should address identified human rights impacts, without the need to address them all simultaneously.[148] Following that, according to UNGPs Principle 24 the most adverse or irremediable human rights risks should be prioritized.[149]

Aligned with the UNGPs, OECD Guidelines for Responsible Business Conduct for Institutional Investors clarify that risk prioritization should be based on the severity of an adverse human rights impact.[150] The severity should be measured according to the Scale or the gravity of the adverse impact; the Scope of the reach of the adverse impact for instance the number of people affected and the Irremediable character meaning any limits on the ability to restore affected human rights in the situation before adverse impact.[151]

Such an approach inherently holds specific limitations as diverse cultural perspectives reveal significant differences in the interpretation and prioritization of human rights globally.[152] Thus, understanding cultural or value-based variations in the geographical context is crucial for

[147] Claire Bright and Karin Buhmann, "Risk-Based Due Diligence, Climate Change, Human Rights and the Just Transition," *Sustainability* 13, no. 18 (January 2021): 4–6, https://doi.org/10.3390/su131810454.
[148] UN Working Group on Business and Human Rights. *Taking Stock of Investor Implementation of the UN Guiding Principles on Business and Human Rights: Addendum Report of the Working Group on the Issue of Human Rights and Transnational Corporations and Other Business Enterprises*. A/HRC/47/39/Add.2. Geneva, June 2021. Accessed June 10, 2024. 5.
[149] United Nations. "Guiding Principles on Business and Human Rights: Implementing the United Nations 'Protect, Respect and Remedy' Framework." New York and Geneva: United Nations, 2011, Guiding Principle 24.
[150] OECD (2017) Responsible business conduct for institutional investors: Key considerations for due diligence under the OECD Guidelines for Multinational Enterprises, 18.
[151] OECD (2017) Responsible business conduct for institutional investors: Key considerations for due diligence under the OECD Guidelines for Multinational Enterprises, 18.
[152] Vishanthie Sewpaul, "The West and the Rest Divide: Human Rights, Culture and Social Work," *Journal of Human Rights and Social Work* 1, no. 1 (March 1, 2016): 37, https://doi.org/10.1007/s41134-016-0003-2.

promoting effective human rights risks assessment that embraces this value-based differences.[153]

As mentioned, the OHCHR Response from September 2013 highlights that assessment process cannot be performed equally for all investments, especially since some financial organizations have a variety of investments in a variety of companies.[154] Challengingly, severe human rights risks may occur in the developed countries also, for instance, Meta faces privacy complaints in 11 EU countries over its plan to use personal data to train AI models without consent, with advocacy group NOYB urging immediate action from national privacy watchdogs due to imminent changes in Meta's privacy policy.[155]

Regardless of the significance given to the prevention, preventive mechanisms are missing from the UNGPs which creates specific challenges.[156] Significant attention is given to remedying the impact after it occurs, however, preventive mechanisms or adequate approaches to prevent human rights harm are lacking.[157] This can lead companies to focus more on reducing risks rather than fully preventing them, resulting in weaker protection measures and developing a social risk mechanism focusing more on risk reduction than full prevention of human rights harm.[158]

Because of that it is important to clarify that social risks and human rights risks are not synonymous.[159] While social risk management may address broader concerns related to a company's reputation or stakeholder relationships, human rights due diligence (HRDD) specifically focuses on identifying, assessing, and reducing risks associated with potential

[153] Sewpaul, 37.
[154] OHCRS June 2013
[155] https://www.business-humanrights.org/en/latest-news/eu-meta-faces-privacy-complaints-in-11-countries-over-the-use-of-personal-data-to-train-ai-models/ , accessed on 08.06.2024.
[156] Mares, "Securing Human Rights through Risk-Management Methods," 522–25.
[157] Mares, 522–25.
[158] Mares, 522–25.
[159] Björn Fasterling, "Human Rights Due Diligence as Risk Management: Social Risk Versus Human Rights Risk," *Business and Human Rights Journal* 2, no. 2 (July 2017): 246–47, https://doi.org/10.1017/bhj.2016.26.

human rights violations.[160] Therefore, risk management should focus on the potential for human rights harm, aiming to completely prevent or eliminate these risks rather than merely minimizing them. Furthermore, a significant issue with the UNGPs lies in the lack of clarity regarding when companies should prioritize the prevention of human rights abuses versus mitigating existing impacts.[161]

Considering that often portfolio investment lists hold multiple companies, the process should identify areas with significant human rights risks and afterward prioritize these for more in-depth analysis.[162] After the identification of risks financial organization is expected to utilize its leverage, address and act upon finding these risks and impacts and take actions to avoid or mitigate human rights risks through various activities, as well as monitor their efficacy.

Simultaneously, when significant or systematic human rights violations are identified before investing, the investor should establish a procedure to consider opting out of the investment.[163] This involves assessing the severity of the abuses and the potential for the investor to engage with the company to effect change, but remains quite hard to determine in which situations an investor could be in a position to intervene and drive change in the investee company behavior.

4.2. Challenges of ESG practices

[160] Fasterling, 246–47.
[161] Mares, "Securing Human Rights through Risk-Management Methods," 527–29.
[162] OECD (2017) Responsible business conduct for institutional investors: Key considerations for due diligence under the OECD Guidelines for Multinational Enterprises, 18-19.
[163] "Analysing OECD National Contact Point Statements for Guidance on Human Rights Due Diligence: Method, Findings and Outlook," 406, accessed June 10, 2024, https://www.tandfonline.com/doi/epdf/10.1080/18918131.2018.1547526?needAccess=true.

As previously mentioned, the pre-investment process is crucial for financial organizations, as they must evaluate the potential human rights impacts of the investee company before deciding to invest. Indicated ESG investing practices emerged by considering non-financial factors in making investment decisions.[164] Therefore, Environmental, Social, and Governance (ESG) factors are additional considerations in financial analysis aimed at reducing risk and improving financial results led by businesses themselves.[165] Environmental factors include for instance energy consumption and pollution in the "E", social factors encompass issues like human rights and community engagement in the "S", while governance factors relate to the quality of management and transparency in the "G".[166] The UN throughout reports highlighted that human rights risks and impacts cannot be one of the elements of ESG investing, hence human rights concerns must be considered concerning all of them. Such a systematic approach to human rights risks and impacts is aligned with expectations for financial organizations.[167]

The reason for that is that impact investing, considering only one element, may also cause human rights harm. For instance, in January 2024 in Portugal residents in Silves filed a lawsuit against Neoen's 96-hectare solar farm project in Algoz, citing concerns over its ecological footprint, lack of community engagement, and proximity to residential areas and critical groundwater resources.[168] The Residents highlights the lack of a detailed Environmental Impact Assessment (EIA) and the project's location on ecologically sensitive land, however, the

[164] Caroline D. Ditlev-Simonsen, "Sustainability and Finance: Environment, Social, and Governance (ESG)," in *A Guide to Sustainable Corporate Responsibility : From Theory to Action*, ed. Caroline D. Ditlev-Simonsen (Cham: Springer International Publishing, 2022), 191, https://doi.org/10.1007/978-3-030-88203-7_9.
[165] Ditlev-Simonsen, 191.
[166] Ditlev-Simonsen, 191.
[167] Wachenfeld, "Strengthening the 'S' in ESG," 220.
[168] https://www.business-humanrights.org/en/latest-news/portugal-community-files-lawsuit-to-halt-neoen-solar-farm-project-over-environmental-and-health-concerns/, See also https://www.portugalresident.com/residents-file-lawsuit-against-massive-solar-farm-project-in-silves/ - accessed on 08.06.2024.

case is ongoing. Additionally, this is important for the general climate action of the EU and important for the integration of 'just transition' as previously mentioned.[169]

Additionally, all data for evaluating ESG performance of a specific company is collected from various sources and analyzed by providers such as MSCI, Bloomberg, and Morningstar.[170] This creates an issue since evident lack of transparency can lead to creating direct links between investments and human rights risks. Most of the ratings developed are based on companies' non-financial reporting, which often fails to accurately reflect the actual situation on the ground. The self-reported data on human rights abuses is frequently biased and inadequate in assessing the severity of such violations, as it lacks verification from independent third parties or accurate auditing processes.[171] Also mentioned that ESG data providers often rely heavily on company-provided information, which may suffer from inaccuracies and unreliability.[172] Although these providers may incorporate additional sources like news and NGO reports to enhance accuracy, they still face limitations in ensuring comprehensive and unbiased data.[173] Therefore, aligning investments with human rights standards is quite challenging due to the lack of human rights data providers, and the inaccuracy of data from those that do exist.

Moreover, discrepancies in data collection and rating methodologies can lead to differing results, making it challenging for investors to assess a company's ESG profile[174], and combined with the undermined role of human rights leads to the complete neglect of human rights concerns. Consequently, financial organizations are in a perfect position to check the quality of given non-financial reports and even advance them, however, it will be discussed in the following chapter. This is important since companies are prone to provide false information,

169 Stark, Gale, and Murphy-Gregory, "Just Transitions' Meanings."
170 Ditlev-Simonsen, "Sustainability and Finance," 2022, 191–92.
171 Bartels and Schramade, "Investing in Human Rights," 208.
172 Bartels and Schramade, 208.
173 Bartels and Schramade, 208.
174 Ditlev-Simonsen, "Sustainability and Finance," 2022, 192.

referred to as "greenwashing", which is a phenomenon where organizations deliberately engage in misleading actions or communications to create a false impression of their environmental or social responsibility.[175]

As mentioned human rights risks are not risks to the enterprise, thus not connected with operational, financial or reputational risks but with the risks that the enterprise creates, contributes to, or is directly linked with.[176] This notion reinforces the concept of double materiality of the investment practices, as embraced by The European Securities and Markets Authority (ESMA) in supporting IFRS Foundation's efforts on international standardization in sustainability reporting published on 16 Dec 2020.[177] Thus, double materiality in sustainable finance and corporate governance involves evaluating sustainability impacts from two perspectives: one focusing on how environmental, social, and governance (ESG) factors affect financial performance and outcomes, and the other emphasizing the broader societal and environmental impacts of economic activities.[178]

From the previously outlined reasons, financial organizations should take into account and gather information from various stakeholders, besides the non-financial disclosure by companies, regarding the investee company's operations. As defined in the OECD Guidelines, stakeholder engagement encompasses interactive processes involving relevant stakeholders, such as meetings, hearings, or consultation sessions.[179] Effective stakeholder engagement is

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175 Sebastião Vieira de Freitas Netto et al., "Concepts and Forms of Greenwashing: A Systematic Review," *Environmental Sciences Europe* 32, no. 1 (February 11, 2020): 10–11, https://doi.org/10.1186/s12302-020-0300-3.
176 OECD (2017) Responsible business conduct for institutional investors: Key considerations for due diligence under the OECD Guidelines for Multinational Enterprises, 12.
177 European Securities and Markets Authority. (2020, December 16). ESMA response to IFRS Foundation consultation on sustainability reporting (Reference No. ESMA32-334-334), https://www.esma.europa.eu/document/esma-response-ifrs-foundation-consultation-sustainability-reporting
178 Iris H-Y Chiu, "The EU Sustainable Finance Agenda: Developing Governance for Double Materiality in Sustainability Metrics," *European Business Organization Law Review* 23, no. 1 (March 1, 2022): 88–90, https://doi.org/10.1007/s40804-021-00229-9.
179 OECD (2017) Responsible business conduct for institutional investors: Key considerations for due diligence under the OECD Guidelines for Multinational Enterprises, 19.

marked by two-way communication and relies on the genuine participation of all involved parties.

Moreover, according to the OECD Guidelines, stakeholder engagement is not only a fundamental expectation but also a crucial method for implementing due diligence. Stakeholders provide valuable insights that help identify human rights risks and impacts, thereby avoiding unreliable and biased non-financial reports. This engagement enhances the visibility of financial organizations by directly interacting with affected stakeholders.

Even though the ESG investing approach holds specific inconsistencies and serves as a valuable tool for investors to fulfill their anticipated responsibility in assessing human rights risks, ESG practices possess a potential for enhancement of the HRDD to achieve a higher level of compliance with human rights standards as well. A critical concern, particularly in jurisdictions with mandatory due diligence laws, is addressing systemic issues like authoritarian regimes, inequality, and poverty.[180] Hence potential advancement for risk analysis may be developed as ESG practice of identifying systemic human rights risks inherent in specific asset classes that may create material risk across the whole class.[181]

One such example is that investors in emerging markets face significant challenges, particularly in real estate and other sectors, due to the complexities of land ownership and acquisition.[182]

In regions like sub-Saharan Africa, inadequate legal frameworks often result in forced evictions and uncompensated land acquisitions, prompting real estate investors to conduct rigorous due diligence to steer clear of such contentious practices.[183] Unfortunately, multiple

[180] Marianna Leite, "Beyond Buzzwords: Mandatory Human Rights Due Diligence and a Rights-Based Approach to Business Models," *Business and Human Rights Journal* 8, no. 2 (June 2023): 210–12, https://doi.org/10.1017/bhj.2023.11.
[181] Wachenfeld, "Strengthening the 'S' in ESG," 231.
[182] Wachenfeld, 231.
[183] Wachenfeld, 231.

human rights risks can be seen in the examples of growing markets, which indicate an even greater need for identifying systemic human rights risks. Infrastructure projects in emerging markets often encounter broader risks beyond land acquisition, including environmental and social impacts.[184] The provided examples highlight the struggles which financial organizations have with ESG investing but at the same time offer an opportunity to improve to achieve expected responsibility to respect human rights.

One specific inconsistency identified between developed ESG practices and HRDD, particularly among more responsible financial organizations, is the prevalent exclusionary screens. The UN report highlighted that financial organizations' responsibility differs from traditional exclusionary screens often employed by investors, which focus on sectors or operating contexts to remove severe human rights risks from investment portfolios.[185] Exclusionary screens have been a fundamental aspect of ESG investing since its inception.[186] Originating from religious communities in pre-revolutionary America, these screens were initially focused on avoiding investments in "sin stocks" associated with industries like tobacco, gambling, alcohol, and slavery.[187] Overtime, they developed into incorporating different values than religious.[188] Research indicates that the most prevalent ESG investing strategy is negative or exclusionary screening, which exacerbates the existing issue.[189]

The study at BI Norwegian Business School found that master's students in Norway prioritize exclusion criteria differently from the general trend in Europe.[190] While controversial

[184] Wachenfeld, 231.
[185] UN Working Group on Business and Human Rights. *Taking Stock of Investor Implementation of the UN Guiding Principles on Business and Human Rights: Addendum Report of the Working Group on the Issue of Human Rights and Transnational Corporations and Other Business Enterprises*. A/HRC/47/39/Add.2. Geneva, June 2021. Accessed June 10, 2024. 5.
[186] Martini, "Socially Responsible Investing," 16881.
[187] Martini, 16881–82.
[188] Martini, 16882.
[189] Ditlev-Simonsen, "Sustainability and Finance," 2022, 196.
[190] Ditlev-Simonsen, 198.

weapons remained a top concern, Norwegian students ranked animal testing higher than tobacco, unlike the broader European trend.[191] Alcohol was least likely to be excluded. This variation reflects cultural differences in values and preferences influencing investment decisions which directly undermines the severity tests as a risk assessment tool.

This ESG practice indicates the necessity for regulatory measures ensuring financial organizations uphold human rights during business decisions influenced by personal and cultural preferences. Moreover, reliance on exclusionary screens can undermine the effectiveness of HRDD processes and its transparency in disclosing human rights findings and actions taken, particularly when financial organizations opt not to invest due to identified human rights risks

In OECD cases analyzed, financial organizations neglected to thoroughly assess whether investee companies were involved in or linked to human rights abuses, failing to take appropriate actions. They also omitted public disclosure of assessment findings and responses to identify risks or abuses, despite available information and stakeholder concerns about ongoing human rights issues related to investee companies.

[191] Ditlev-Simonsen, 198.

5. Human Rights due diligence throughout the investment lifecycle

The second part of Human Rights Due Diligence (HRDD) defines that financial organizations should prevent and mitigate adverse human rights impacts associated with their investments throughout the investment lifecycle. Additionally, scholars have supported this as establishing the 'international corporate law,' particularly concerning the UNGPs and OECD guidelines, which aim to address the limitations of national laws that frame corporate governance in a more conventional context.[192]

Appropriateness of action, according to OECD Guidelines[193], depends on the investor's connection to the human rights risk or impact in its business relationships upon identification, which may appear in three distinct forms.

First, investors may cause adverse impacts through their own business activities, like affecting their own employees or reducing someone's ability to enjoy a human right. In the investment relationship, this may occur when financial organizations have a controlling stake in an investee company. Second, they can contribute to these impacts either directly through their business activities or indirectly through business relationships or investments, e.g. where they hold significant ownership stakes. Thirdly, they can be directly associated with these impacts through their activities, products, or services, in which case they did not cause or contribute to but are linked with an investee company that caused or contributed to the harm.

[192] Guido Ferrarini, "Sustainable Governance and Corporate Due Diligence: The Shifting Balance Between Soft Law and Hard Law," in *The Palgrave Handbook of ESG and Corporate Governance*, ed. Paulo Câmara and Filipe Morais (Cham: Springer International Publishing, 2022), 47–50, https://doi.org/10.1007/978-3-030-99468-6_2.
[193] OECD (2017) Responsible business conduct for institutional investors: Key considerations for due diligence under the OECD Guidelines for Multinational Enterprises, 34-36.

Thus, a financial organization that owns or manages minority shares in an investee company may be involved with human rights impacts when the investee company is causing or contributing to harm.

5.1. Assessment of the financial organization's position

The important part of the HRDD is that investors should evaluate their position along the spectrum of causing, contributing to, or being linked to human rights harm and respond accordingly.[194] As previously highlighted, the percentage of shares owned by financial organizations are among the key factors in determining their level of causation, and their role thus enabling financial organizations to perform expected conduct upon identified level of causality.

However, assessment of the linkages between the ownership or management of shares with the human rights harm caused by an investee company may face challenges. The main concern is assessing the extent of the financial organization's involvement with human rights risks. Besides share ownership, multiple factors indicate the investor's position regarding the three levels of causation.

5.2. Challenges to the assessment of the position

[194] UN Working Group on Business and Human Rights. *Taking Stock of Investor Implementation of the UN Guiding Principles on Business and Human Rights: Addendum Report of the Working Group on the Issue of Human Rights and Transnational Corporations and Other Business Enterprises*. A/HRC/47/39/Add.2. Geneva, June 2021. Accessed June 10, 2024. 5-7. https://www.ohchr.org/EN/Issues/Business/Pages/WGHRandtransnationalcorporationsandotherbusiness.aspx.

5.2.1. Direct linkage vs contribution

In light of the above, among the core questions to determine the level of causation with human rights risks or impacts is the degree of control that the financial organization has over the investee company. Following that, complex corporate governance issues additionally challenge the determination of the level of linkages that a financial organization has with human rights risks.

However, the ownership or managing of majority shares in the investee company may be a relevant indicator to determine that the financial organization as an investor has directly caused human rights harm, this may also not be true. The evolution of modern companies developed in such a manner that ownership to some extent separated from the control over the investee company.[195] Ownership and control in corporations vary in diverse business structures, each influencing decision-making and management differently, thus not being generally applicable.

Therefore, in private corporations, near-complete ownership by individuals or small groups consolidates control, allowing for direct and determinative influence over company affairs.[196] Majority control, attained through ownership or managing of the majority of outstanding shares, grants significant power, though minority shareholders may not necessarily be completely powerless.[197]

Hence, multiple other legal tools may be used to gain or lose control regardless of the ownership over the majority of shares. For instance, legal devices like pyramiding and non-

[195] "The Modern Corporation and Private Property," Routledge & CRC Press, 66, accessed June 8, 2024, https://www.routledge.com/The-Modern-Corporation-and-Private-Property/Berle/p/book/9780887388873.
[196] "The Modern Corporation and Private Property," 67.
[197] "The Modern Corporation and Private Property," 67–68.

voting stock enables control without the majority ownership, often through intricate ownership arrangements.[198] Even in cases if a financial organization has majority of shares, these - or a portion thereof - may be non-voting stocks transferring control into the hands of those with voting stocks.

Even more challenging are different ownership arrangements such as voting trustees that hold voting rights on behalf of shareholders, separating control from ownership.[199] Moreover, ownership arrangements in corporations can vary based on factors like legal structure, degree of ownership, control mechanisms, voting rights, management involvement, and responsibilities. These variations shape the dynamics of ownership and control within the organization and challenge the identification of the involvement of financial organization with human rights harm.

For instance, institutional investors, accounting for approximately 79.65% of Meta's total shares outstanding, play a significant role in the ownership structure of the company.[200] Vanguard Group Inc. holds approximately 8.47% of Meta's shares, followed by BlackRock Inc. with 7.16%, and FMR LLC/Fidelity Investments with 6.1%, therefore these institutional shareholders wield substantial influence over Meta's decision-making and corporate governance due to their sizable ownership stakes notwithstanding that all of them own less than 10%. This is so, however, only because there is a number of shareholders with substantial stakes in the equity (ownership) of Meta. However, the identification of whether a financial organization caused or contributed to the harm is construed around the control that financial organization has, but it must be assessed considering also other factors especially considering the size and specificities of each company.

[198] "The Modern Corporation and Private Property," 66–69.
[199] "The Modern Corporation and Private Property," 67–69.
[200] https://www.investopedia.com/articles/insights/082216/top-9-shareholders-facebook-fb.asp, accessed on 08.06.2024.

Additionally, the managing board's specific individual responsibilities regarding human rights concerns may be undermined by the broader responsibilities of the financial organization.

5.2.2. Contribution vs. the direct linkage

However, the second delineation between contribution and direct linkage with human rights impacts is even more challenging. Financial organizations typically invest in minority shares, resulting in limited control over investee companies. Consequently, their level of involvement often falls within the categories of either contributing to or being directly linked to human rights abuses, as outlined in the provided OECD cases. Moreover, OECD Guidelines indicate that investors will in most instances not cause or contribute to but only be directly linked with the harm.[201]

This is to a certain extent a troublesome evaluation since the UN report from June 2017 indicated that in practice there is a continuum between contributing to and having a direct link to an adverse human rights impact.[202] This means that causal relationship may change over time depending on the financial organizations own actions or omissions regardless of the impacts of the investee company. Even if a financial organization holds only minority shares and lacks any control over the investee company, it can still contribute to human rights impacts if it fails to address issues connected to the investee company by not using its leverage.

[201] OECD (2017) Responsible business conduct for institutional investors: Key considerations for due diligence under the OECD Guidelines for Multinational Enterprises, 20.
[202] United Nations High Commissioner for Human Rights. *OHCHR Response to Request from BankTrack for Advice Regarding the Application of the UN Guiding Principles on Business and Human Rights in the Context of the Banking Sector*. 12 June 2017. 6.

However, minority shareholders can wield significant influence within a corporation despite holding a relatively small percentage of shares.[203] The scholars recognized "working control," as a case when an individual or a small group with substantial share interests can dominate corporate affairs.[204] This control hinges on their capacity to gather proxies from dispersed shareholders, consolidating their minority stake with proxy votes to secure a majority during annual elections.[205]

Among some of the examples is the ExxonMobil situation. ExxonMobil's largest shareholders, including BlackRock, Vanguard, State Street, and Fidelity, had significant leverage to influence the company's alignment with human rights and environmental standards by voting for new, climate-focused board members. Their collective ownership of nearly 20% of ExxonMobil's shares positioned them to drive the company towards a net-zero energy future, consistent with their public commitments to sustainable investing.[206]

This shareholder vote serves as a crucial test of the investors' willingness to use their influence to address significant concerns and promote long-term, responsible business practices within the investee company. Examples like this indicate the nuanced dynamics of power within organizations, as well as how minority shareholders can have a form of control over decisions and management practices.

In essence, the extent to which investors are seen as directly contributing to or mitigating harm caused by an investee company's negative human rights impacts depends on their level of control over the investee company. This level of control determines whether investors can influence and address these impacts effectively.

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[203] "The Modern Corporation and Private Property," 75–78.
[204] "The Modern Corporation and Private Property," 77.
[205] "The Modern Corporation and Private Property," 78.
[206] https://www.edf.org/blog/2021/05/21/defining-moment-exxonmobils-biggest-shareholders-and-climate, - accessed on 22.05.2024.

If investors possess significant control, they are expected to actively engage and take responsibility for mitigating human rights risks within the investee company. Conversely, if their control is limited, their ability to influence and address these impacts may be constrained, raising questions about their direct contribution to any harm caused.

Therefore, the assessment of investor responsibility often centers around the degree of control they exert over the investee company and their proactive use of that influence to address human rights issues. As previously mentioned, that influence is framed as leverage in the UNGPs.

The latest Banktrack report identified that 39 out of 50, which means 78% of financial organizations analyzed, do not indicate whether they assess their role as investors within the investee company in causing or contributing to adverse human rights impacts.[207] Feedback highlighted a common misconception: simply having a risk assessment framework is seen as sufficient evidence that a bank evaluates its relationship to such impacts.[208] Without an ongoing assessment process to evaluate the extent of their involvement in human rights violations, financial organizations cannot determine the appropriate measures to take or how to effectively use their leverage to address potential or existing human rights risks and impacts.

5.3 Leverage-based responsibility in cases of direct linkage

Furthermore, despite limited ownership of financial organizations in investment portfolios, they bear a responsibility to ensure that their investments do not lead to or support

[207] The BankTrack Global Human Rights Benchmark 2022, Published 17th November 2022, Banktrack, https://www.banktrack.org/download/global_human_rights_benchmark_2022/global_human_rights_benchmark_2022_2.pdf , accessed on 08.06.2024.
[208] Iibid.

human rights violations. Hence, it applies in situations where financial organizations as minority shareholders in investee companies may be responsible for not using gained influence over the investee company and later on result in contributing to human rights harm. This is also important as UNGPs Principle No.13 identifies that when investors are directly linked with negative human rights impacts stemming from their investment activities, they are obligated to leverage their influence to mitigate and address the harm caused or contributed to by other actors.[209]

Consequently, in cases of minority shareholders this is construed to enhance the leverage-based responsibility compared to the impact-based responsibility.[210] UNGPs define that a company has leverage when it can effect change in the wrongful practices of an entity that causes harm.[211] Moreover, this type of responsibility is crucial in situations where a company is directly linked to human rights harms through its business relationships, even if it is not the direct perpetrator.[212]

Impact-based responsibility focuses on a company's direct and indirect contributions to social or environmental impacts, whereas leverage-based responsibility centers on the company's influence over other actors regardless of direct attribution of impacts.[213] On the contrary, leverage-based responsibility focuses on a company's influence over other actors through its relationships, regardless of whether it directly causes measurable impacts.[214]

[209] UN Working Group on Business and Human Rights. *Taking Stock of Investor Implementation of the UN Guiding Principles on Business and Human Rights: Addendum Report of the Working Group on the Issue of Human Rights and Transnational Corporations and Other Business Enterprises*. A/HRC/47/39/Add.2. Geneva, June 2021. Accessed June 10, 2024. 6-7.
[210] Wood, "The Case for Leverage-Based Corporate Human Rights Responsibility," 64–66.
[211] Ana Rita Campos, "The Role of Companies in Promoting Human Rights," in *The Palgrave Handbook of ESG and Corporate Governance*, ed. Paulo Câmara and Filipe Morais (Cham: Springer International Publishing, 2022), 183, https://doi.org/10.1007/978-3-030-99468-6_9.
[212] Wood, "The Case for Leverage-Based Corporate Human Rights Responsibility," 65.
[213] Wood, 64–66.
[214] Wood, 65.

In the case of leverage-based responsibility, recognized as the continuum by the UN, if a financial organization as the investor does not exercise its leverage it may result in contributing to human rights harm which creates a responsibility to remedy the harm to the extent done. That is why leverage is key for financial organizations as investors respect for human rights.

In some of the already resolved OECD cases, it was emphasized that financial organizations have an independent responsibility to exercise individual leverage to prevent or mitigate the impacts of their business conduct.[215] Moreover, financial organizations must be prepared to increase this leverage if necessary, concerning their clients. This indicates that leverage does construe a specific duty that must be utilized to respect human rights, as active ownership over investments and involvement with those risks and impacts.

This specific form of responsibility is important as it challenges the traditional shareholder primacy model by considering stakeholder interests and enhances the longer practices within financial and investing services.[216] Therefore, HRDD aligns with the recognition that integrating human rights concerns into companies' practices may not always prioritize profit.[217] However, the leverage may not only be exercised through voting rights, which aligns with broader ESG practices that offer suitable practices.

5.3.1. ESG broader practices - Litigation

[215] "Analysing OECD National Contact Point Statements for Guidance on Human Rights Due Diligence," 405.
[216] John Sherman, "Human Rights Due Diligence and Corporate Governance," SSRN Scholarly Paper (Rochester, NY, April 29, 2022), 26–28, https://doi.org/10.2139/ssrn.3862624.
[217] Benjamin Gregg, "Beyond Due Diligence: The Human Rights Corporation," *Human Rights Review* 22, no. 1 (March 1, 2021): 84–88, https://doi.org/10.1007/s12142-020-00605-x.

Comparatively, ESG investing is broader extending to active ownership, encouraging the inclusion of ESG considerations in ownership policies and practices.[218] It was also recognized as ESG stewardship that involves shareholders actively engaging with their investee companies to address ESG issues.[219] Additionally, practices include the invested entities to provide appropriate disclosure on ESG matters.

Despite the leverage being exercised through the usage of voting rights it may have different approaches, such as litigation.

One of the examples of utilizing leverage is the ClientEarth vs. Enea. In ClientEarth v. Enea[220], the Poznań Regional Court invalidated Enea's resolution to construct a €1.2 billion coal-fired power plant, ruling that it exceeded the general meeting's powers and violated the Polish Commercial Companies Code regarding the board of directors' duties. ClientEarth, a shareholder and environmental law organization, argued that the project posed significant climate-related and simultaneously financial risks, which the board did not take into account. Although this aligned financial and indirectly non-financial concerns, as a result, the company abandoned the coal plant project.

This example portrays how investors can utilize their leverage, outside of voting rights, to advance human rights concerns and risks that are directly linked to their investments. If the financial organization does not have sufficient leverage, it should put some effort into building it, however, the financial organization should divest in cases if the change within the investee company is not happening.

[218] Paulo Câmara, "The Systemic Interaction Between Corporate Governance and ESG," in *The Palgrave Handbook of ESG and Corporate Governance*, ed. Paulo Câmara and Filipe Morais (Cham: Springer International Publishing, 2022), 5, https://doi.org/10.1007/978-3-030-99468-6_1.
[219] Tim Bowley and Jennifer G. Hill, "The Global ESG Stewardship Ecosystem," *European Business Organization Law Review*, April 29, 2024, 5, https://doi.org/10.1007/s40804-024-00316-7.
[220] *ClientEarth v. Enea*, Filing Date 2018, Poland Regional Court in Poznań, Principal Laws: Poland Polish Commercial Companies Code, accessed June 8, 2024, https://climatecasechart.com/non-us-case/clientearth-v-enea/.

Limitations were identified as ESG investing aims to constrain managers but often grants them more freedom, while corporate governance structures still heavily incentivize profit maximization over ESG goals.[221]Also, there is difficulty in measuring benefits to non-shareholder constituencies compared to shareholder returns which complicate the pursuit of meaningful ESG objectives.[222] Additionally, there is a growing concern that ESG initiatives may serve as a shield for management against takeovers and criticism.[223]

[221] Macey, "ESG Investing," 285–91.
[222] Macey, 287–91.
[223] Macey, 288–91.

6. CONCLUSION

The application of the UNGPs to the financial sector, particularly in investing, presents various challenges and uncertainties. Despite efforts to clarify the scope of responsibility for financial organizations, ambiguities persist regarding the extent of their obligation to conduct human rights due diligence (HRDD) and address human rights impacts. While the UNGPs outline the necessity for a preventive and reactive approach to human rights risks, debates continue regarding the level of accountability for financial organizations, especially concerning their involvement in human rights harm caused by investee companies. The lack of clarity and effective implementation of HRDD processes among financial organizations indicates the need for mandatory regulations and compliance mechanisms to ensure adherence to human rights standards. Such regulations could provide clearer guidelines on the expectations for HRDD and define the extent of corporate accountability in respecting human rights within the financial sector.

Analyzed cases illustrate the growing need for financial organizations to prioritize and rigorously implement soft law standards. These frameworks are essential for identifying, preventing, and mitigating human rights abuses associated with their investments. Moreover, provided cases signify shortcomings in current practices, revealing gaps in compliance with soft law standards and in leveraging corporate influence effectively to address human rights violations within investee companies. Following that, the persistence of ambiguities, especially concerning the uniqueness of the financial business relationships and the role of the HRDD, surrounding the extent of financial organizations' responsibilities indicates the urgent need for clearer guidelines and enhanced transparency in HRDD processes.

Financial organizations, as investors, have a crucial responsibility to address human rights risks and adverse impacts associated with their investment activities, as outlined by the UNGPs and OECD guidelines.

HRDD for financial organizations in the investment sector lies in its critical role in mitigating human rights risks and promoting responsible investing practices. Aligned with international frameworks like the UNGPs and OECD Guidelines, HRDD enables financial institutions to systematically identify, assess, and address potential human rights impacts across their investment portfolios. By prioritizing risks with the highest severity, HRDD facilitates proactive risk management and supports efforts to prevent adverse human rights outcomes. Moreover, effective HRDD involves engagement with investee companies and stakeholders to implement remediation measures, enhancing transparency and accountability in financial operations.

In contrast, challenges within ESG practices highlight inconsistencies in integrating human rights considerations, often due to reliance on self-reported data and the limitations of exclusionary screens. To strengthen alignment with human rights standards, financial organizations must enhance their due diligence processes, ensuring robust assessments and disclosures that encompass human rights impacts comprehensively. This approach not only enhances risk management but also fosters ethical conduct and contributes to sustainable investment practices globally.

Moreover, financial organizations' responsibility requires continuous HRDD throughout the investment lifecycle, assessing their causation, contribution, or linkage to human rights harm. Investors must act appropriately based on their level of involvement, whether they directly cause harm, contribute to it, or are merely linked to it. Challenges arise in determining the extent of control and influence, especially with complex corporate governance structures.

However, the distinction between contribution and direct linkage remains nuanced, necessitating ongoing assessment and active engagement. Despite these complexities, financial organizations must transparently communicate their efforts, utilizing leverage to prevent and remedy human rights impacts, thus fulfilling their international corporate law obligations and ensuring responsible business conduct.

The concept of leverage-based responsibility in HRDD indicates financial organizations' obligation to mitigate human rights risks linked to their investments, even as minority shareholders. This approach, guided by UN principles, emphasizes proactive engagement and stewardship beyond profit-driven motives. Broader ESG investing practices, like litigation, exemplify avenues for investors to influence corporate behavior toward human rights. Nevertheless, challenges persist, necessitating clearer regulatory frameworks to ensure consistent adherence to global human rights standards. Strengthening leverage-based responsibility promotes ethical investment practices that balance financial returns with societal impacts and accountability.

Despite growing awareness of the intersection between financial activities and human rights concerns, financial organizations largely remain detached from these ethical considerations. The figurative "red tape"[224] that divides financial objectives from human rights responsibilities complicates the comprehensive integration of ethical practices, while this thesis aims to highlight the myriad complexities surrounding the financial sector's engagement with human rights and captures the current state of the ongoing changes within financial systems.

[224] "Red Tape," Oxford English Dictionary, accessed June 12, 2024, https://www.oed.com/dictionary/red-tape_n?tab=factsheet#26406309.

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