

The application of the Guiding Principles on Business and Human Rights to minority shareholdings of institutional investors

Introduction

On 26 February 2013 OHCHR received a request via email from the Centre for Research on Multinational Corporations and OECD Watch to clarify certain issues relating to the interpretation of the Guiding Principles on Business and Human Rights¹ Specifically, OHCHR was asked to provide interpretative guidance on the following questions:

1. Do the Guiding Principles apply to institutional investors holding minority shareholdings, such as pension funds?
2. If so, do such shareholdings constitute a “business relationship” as defined by the Guiding Principles?
3. What guidance do the Guiding Principles provide with regard to the question of leverage when an entity is linked to an alleged human rights abuse through its business relationships, in the context described above (if applicable)?

The present brief does not express an opinion about any specific cases or the acts of any specific institutions or enterprises. The sole purpose is to provide interpretive guidance on the Guiding Principles with regard to the specific questions posed.

In preparing this interpretative guidance, OHCHR has consulted with the Working Group on the issue of human rights and transnational corporations.²

1. Applicability of the Guiding Principles to institutional investors holding minority shares

Guiding Principle 14 sets out the scope of application of the corporate responsibility to respect human rights and stipulates that “[t]he responsibility of business enterprises to respect human rights applies to *all* enterprises regardless of their size, *sector*, operational context, ownership and structure”(emphasis added).

Even though the Guiding Principles do not explicitly reference institutional investors, the application of the Guiding Principles to all enterprises regardless of sector is understood to also comprise all enterprises in the financial sector, including institutional investors.

There is nothing in the text of the Guiding Principles to indicate that their scope of application is limited to situations where institutional investors hold majority shareholdings. This may be relevant when considering the means through which a business enterprise meets its responsibility to respect human rights, including the leverage it can exercise in its business relationships (discussed in section 3), but is not relevant to the question of *the existence of the responsibility*.

¹ Contained in Human Rights Council report A/HRC/17/31. The Guiding Principles were unanimously endorsed by Human Rights Council Resolution 17/4)

² See report by the United Nations Secretary-General entitled “Contribution of the United Nations system as a whole to the advancement of the business and human rights agenda and the dissemination and implementation of the guiding Principles on Business and Human Rights”, A/HRC/21/21, paragraph 96.

In conclusion, it is the view of OHCHR that the Guiding Principles apply to institutional investors holding minority shareholdings.

2. Do minority shareholdings held by institutional investors constitute a “business relationship” as per GP 13 (b)

A business enterprise may be involved in an adverse human rights impact by either

- a) Causing or contributing to the adverse human rights impacts through its own activities (GP 13 (a));
- b) As a result of its business relationships with other parties where the adverse impacts are directly linked to its own operations, products or services by such business relationships, even if the business enterprise has not contributed to those impacts (GP 13 (b)).

The following interpretative guidance is based on the assumption that the question is concerned with scenario b), i.e. where the institutional investor is *not* itself contributing to an adverse impact, but is linked to such impact solely by their business relationships.

“Business relationships” are understood in the Commentary to GP 13 to include “relationships with business partners, entities in its value chain, and any other non-State or State entity directly linked to its business operations, products or services.” OHCHR’s Interpretive Guide on the Corporate Responsibility to Respect Human Rights³ further elaborates that business relationships “include indirect business relationships in its value chain, beyond the first tier, and minority as well as majority shareholding positions in joint ventures”.⁴ The use of the word “include” suggests that the examples of business relationships are non-exhaustive and illustrative. There is no indication that minority ownership outside the context of joint ventures would be excluded from the scope of application of GP 13 (b).

In other words, the determining factor to establish a business relationship in terms of GP 13 (b) is whether there is a link between an impact arising from the activities of an entity in which a minority investor holds shares and the operations, products or services of that minority shareholder. The relative size or percentage of the share an institutional investor holds in a company is *not* a factor in determining whether there is a business relationship for the purposes of GP 13 (b). Rather, it can be a factor in determining what measures the institutional investor is expected to take to prevent or mitigate any adverse human rights impacts which are linked to its operations, products or services through the business relationship, as stipulated in GP 19.

Institutional investors typically invest funds—their own or on behalf of clients—in various assets, which may include minority shareholdings. Impacts arising from the activities of the entities in which an investor has a minority shareholding can therefore reasonably be considered as being directly linked to the investors’ operations, products or services.

³ <http://www.ohchr.org/Documents/Issues/Business/RtRInterpretativeGuide.pdf>. The Guide was issued with the purpose of providing additional background explanation to 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.

⁴ See definition of business relationship, *ibid.* page 5.

It should be added that it is also common practice among some institutional investors to engage with the companies in which they invest to promote good corporate governance as part of a strategy to safeguard investments. Such engagement suggests an implicit recognition of a business relationship between the entities concerned.

In conclusion, it is the view of OHCHR that minority shareholdings of institutional investors constitute a “business relationship” for the purposes of Principle 13(b).

3. How should the question of leverage be assessed in the context of minority shareholdings?

Guiding Principle 19 (b) stipulates that business enterprises should take appropriate action to prevent and mitigate adverse human rights impacts. Appropriate action will vary according to:

- (i) Whether the business enterprise causes or contributes to an adverse impact or whether it is involved solely because the impact is directly linked to its operations, products or services by a business relationship;
- (ii) The extent of its leverage in addressing the adverse impact.

As stated above, this brief focuses on the responsibility of institutional investors with minority shareholdings who are involved in an adverse impact solely because the impact is directly linked to its operations, products or services by a business relationship. This brief does not discuss situations where institutional investors themselves contribute to an adverse impact.

Where a business enterprise is linked to an adverse impact through a business relationship, the Commentary to GP 19 recognizes that the situation is complex. According to the Interpretive Guide, the actions to be considered are less straightforward than if the enterprise is causing or contributing to the impact itself, as it “has the least direct control or influence over whether that impact occurs” in a linkage situation.⁵ However, the Guiding Principles do provide clear guidance on the key issues that need to be considered.

The commentary to Guiding Principle 19 states that, among the factors that will enter into the determination of the appropriate action in such situations are the enterprise’s leverage over the entity concerned, how crucial the relationship is to the enterprise, the severity of the abuse, and whether terminating the relationship with the entity itself would have adverse human rights consequences.

The concept of leverage is defined in the Interpretive Guide as “an advantage that gives power to influence. In the context of the Guiding Principles, it refers to the ability of a business enterprise to effect change in the wrongful practices of another party that is causing or contributing to an adverse human rights impact.”⁶

The Interpretive Guide presents these considerations, in general terms, in the following decision matrix:

⁵ Interpretive Guide, Ibid. page 48.

⁶ Ibid. page 7.

	Have leverage	Lack leverage
Crucial business relationship	<p>A.</p> <ul style="list-style-type: none"> ➤ Mitigate the risk that the abuse continues/recurs ➤ If unsuccessful 	<p>B.</p> <ul style="list-style-type: none"> ➤ Seek to increase leverage ➤ If successful, seek to mitigate risk that the abuse continues/recurs ➤ If unsuccessful, consider ending the relationship;** or demonstrate efforts made to mitigate abuse, recognizing possible consequences of remaining
Non-crucial business relationship	<p>C.</p> <ul style="list-style-type: none"> ➤ Try to mitigate the risk that the abuse continues/recurs ➤ If unsuccessful, take steps to end the relationship* 	<p>D.</p> <ul style="list-style-type: none"> ➤ Assess reasonable options for increasing leverage to mitigate the risk that the abuse continues/recurs ➤ If impossible or unsuccessful, consider ending the relationship*

* Decisions on ending the relationship should take into account credible assessments of any potential adverse human rights impact of doing so.

** If the relationship is deemed crucial, the severity of the impact should also be considered when assessing the appropriate course of action.

In line with the commentary to GP 19, where an investor with a minority shareholding has leverage to prevent or mitigate an adverse impact, it should exercise it.

Whether a minority shareholder has leverage over the entity concerned and can effect change in the wrongful practice that is causing or contributing to an adverse human rights impact, may depend on the size of the shareholding (percentage of total number of the shares).

However, several other factors may also affect a minority shareholder's leverage, such as:

- Whether there is otherwise a degree of direct control by the minority shareholder over the entity;
- The ability of the minority shareholder to incentivize the entity to improve its human rights performance through future business, reputational advantage, capacity-building, etc.;
- The benefits to the entity's reputation of the relationship with the minority shareholder and the harm to its reputation if that relationship is withdrawn;
- The ability of the minority shareholder to engage e.g. business associations and multi-stakeholder initiatives to incentivize behaviour change in the entity's sector or industry;

- The ability of the minority shareholder to engage local or central government in requiring improved human rights performance by the entity through the implementation of regulations, monitoring, sanctions, etc.;
- The ability of the shareholder to influence other shareholders of the concerned entity to insist that it address the situation.⁷

In situations where the minority shareholder finds it lacks leverage, it should consider ways in which it may increase its leverage to prevent or mitigate the human rights risk. This could, for example, involve filing shareholder proposals or entering into dialogue with other shareholders to build alliances for voting on the issue at shareholder meetings. Dialogue with authorities and relevant industry associations could also be considered.

As part of a strategy to increase leverage, it may be effective to engage with relevant expertise to document the consequences of the adverse impacts on human rights and possibly to the investment itself, in the form of increased costs/opportunity costs due to reputational, legal and operational risks. The shareholder should also consider whether a public statement to clarify its expectations may increase its leverage, or whether a more cautious behind-the-scene approach may be more effective.

Where a minority shareholder lacks leverage and cannot increase it should consider ending the relationship by disinvesting/selling its shares. The decision on ending the relationship should take into account credible assessments of any potential adverse human rights impact of doing so. Wherever possible, the shareholder should take steps to consult with potentially affected stakeholders on their proposed approach.

The Commentary to GP 19 emphasizes that the severity of the adverse human rights impact is an important factor in considering whether to continue the relationship. The more severe the abuse, the more quickly a business enterprise will need to see change before it takes a decision on whether it should end the relationship, including in situations where the relationship can be considered a “crucial” one. In any case, for as long as the abuse continues and a business enterprise remains in the relationship, it should be able to demonstrate its own ongoing efforts to mitigate the impact and be prepared to accept any consequences – reputational, financial or legal – of the continuing connection.

In conclusion, institutional investors would be expected to seek to prevent or mitigate human rights risks identified in relation to shareholdings – including minority shareholdings. The Guiding Principles set out that the appropriate action in response to the identified risk depends on the degree of its leverage, where a number of options should be considered with a view to use or enhance leverage, to effect change in terms of ending harmful practice and mitigating risks of human rights abuse. If efforts in this regard are not successful, the Guiding Principles stipulate that the institutional investor should consider ending the relationship.

⁷ Most listed examples have been adapted from Interpretative Guide page 49.