



GLOBAL FORUM ON RESPONSIBLE BUSINESS CONDUCT

Scope and application of 'business relationships' in the financial sector under the OECD Guidelines for Multinational Enterprises

26-27 JUNE 2014

OECD CONFERENCE CENTRE

PARIS, FRANCE



This document serves as reference material for the session on Responsible Business Conduct in the Financial Sector of the Global Forum on Responsible Business Conduct taking place in Paris on 26-27 June 2014. It was prepared by Tyler Gillard, Barbara Bijelic and Ellen van Lindert from the Investment Division of the OECD Directorate for Financial and Enterprise Affairs. It was approved by the OECD Responsible Business Conduct Working Party at its meeting on 20 March 2014.

SCOPE AND APPLICATION OF ‘BUSINESS RELATIONSHIPS’ IN THE FINANCIAL SECTOR UNDER THE OECD GUIDELINES FOR MULTINATIONAL ENTERPRISES

Introduction

The OECD Guidelines for Multinational Enterprises (the Guidelines) and the UN Guiding Principles on Business and Human Rights (UNGPs) are an important contribution to the body of globally recognised standards for responsible business conduct. Enterprises should carry out risk-based due diligence to identify, prevent and mitigate actual and potential adverse impacts and account for how these impacts are addressed.¹ An enterprise should:

- a) “Avoid causing or contributing to adverse impacts on matters covered by the Guidelines, through their own activities, and address such impacts when they occur”², and;
- b) “Seek to prevent or mitigate an adverse impact where they have not contributed to that impact, when the impact is nevertheless directly linked to their operations, products or services by a business relationship. This is not intended to shift responsibility from the entity causing an adverse impact to the enterprise with which it has a business relationship.”³

On the basis of the research performed by the Sustainable Finance Advisory (SFA),⁴ the OECD Multi-stakeholder Advisory Group on the Financial Sector (AG) has made several recommendations to the Working Party on Responsible Business Conduct (WPRBC).⁵ The WPRBC tasked the Secretariat with the preparation of four papers for its consideration on:

- a) The scope and application of business relationships;
- b) How the Guidelines are applicable by Sovereign Wealth Funds, and to Central Banks governing them;
- c) The terminology on ‘adverse impacts directly linked to operations, products or services by a business relationship’ in the context of the financial sector;
- d) A follow-up work plan on the recommendations of the Advisory Group.

On the basis of the SFA research, it was concluded that “Of the FI study participants, some refer to the OECD Guidelines in their E&S policies, but few use them in the implementation of E&S due diligence as they are seen as too generic. It should be noted that this does not mean that FIs do not have E&S due

¹ OECD Guidelines for Multinational Enterprises, Chapter II, paragraph 10

² OECD Guidelines for Multinational Enterprises, Chapter II, paragraph 11

³ OECD Guidelines for Multinational Enterprises, II, paragraph 12

⁴ See Sustainable Finance Advisory, “Environmental and Social Risk Due Diligence in the Financial Sector” (2013)

⁵ Proactive Agenda Project on Due Diligence in the Financial Sector: Recommendations by the Advisory Group (2013).

diligence policies/processes in place. Many FIs cite a lack of clarity on terminology, for example, “business relationships” and “business partners”, “direct” links to adverse impacts [...]”.⁶

This document is a note from the Secretariat regarding the understanding of the scope and applicability of the Guidelines within the financial sector. This concerns the description of the term “business relationships” and what is meant by this term under the Guidelines. The description of the term ‘directly linked’ to an MNEs’ operations, services or products by a business relationship (including the issues of minority shareholding in investee companies) is closely related to the above, but has a higher level of complexity. For this reason, the secretariat has prepared a separate note on the subject and a proposal is under preparation to follow-up on the AG recommendation to provide clarity on this by means of a multi-stakeholder project, with a view to develop practical guidance for the financial sector to help them observe the Guidelines.⁷ The document also serves to inform the discussions as part of the agreement of the Investment Committee with regards to addressing four priority issues regarding the applicability of the Guidelines within the financial sector (of which the meaning of “business relationships” in the financial sector is one).⁸

The Guidelines’ expansive description of ‘business relationships’

The Guidelines are recommendations addressed by governments to MNEs. They provide principles and standards of good practice consistent with applicable laws and internationally recognised standards. Observance of the Guidelines by enterprises is voluntary and not legally enforceable.⁹ Their non-binding character has implications for use of the terms “application” and “scope”. This understanding is reflected throughout the text of the Guidelines in the use of appropriate terms and the conscious avoidance of terms that might have unintended legal connotations, such as “obligation”, “violation” “breach”, “compliance” and “duty”.

The Guidelines state that a precise definition of MNEs is not required for their purposes, since they are aimed at the widest possible observance.¹⁰ MNE’s include enterprises in all sectors of the economy

⁶ Sustainable Finance Advisory, “Environmental and Social Risk Due Diligence in the Financial Sector” (2013) p. 76

⁷ To serve that project, the Secretariat has prepared a Note on the terminology on ‘directly linked’ in the context of the financial sector. Upon request of the Chair of the WPRBC, the Former UN Secretary-General’s Special Representative for Business and Human Rights (Professor Ruggie); the United Nations Office of the High Commissioner for Human Rights (OHCHR); and the UN Working Group on Business and Human Rights have sent letters in which they express the views of their respective organisations on the matter with regards to the UNGPs, with which the Guidelines are aligned.

⁸ These are (a) the meaning of “business relationships” in the financial sector (terms found in chapter II, paragraphs A.12 and chapter IV, paragraph 3 of the Guidelines) ; (b) the application of the Guidelines to sovereign wealth funds and central banks; (c) the meaning of “impacts directly linked to their business operations, products or services by a business relationship” (terms also used in chapter II, paragraph 12 A.12 and chapter IV, paragraph 3 of the Guidelines); and (d) coordination between NCPs with respect to complex and multi-layered specific instances.

⁹ OECD Guidelines for Multinational Enterprises, Chapter I, paragraph 1

¹⁰ OECD Guidelines for Multinational Enterprises, Chapter I, paragraph 4 and 6

and ownership may be private, State or mixed.¹¹ Accordingly, the Guidelines are applicable by enterprises in the financial sector.¹²

The Guidelines provide the following description of business relationships:

“The term ‘business relationship’ includes relationships with business partners, entities in the supply chain and any other non-State or State entities directly linked to its business operations, products or services”.¹³

The use of the word ‘includes’ indicates that this is a non-exhaustive and illustrative list of examples; hence business relationships can go beyond the examples given. It is precisely because the Guidelines are recommendations and not legally enforceable that open-ended descriptions of what is meant by business relationships can be used. A legal understanding would require much more precision with regard to their scope and applicability.

Moving on to the matter of financial investments¹⁴ two issues are most relevant regarding the observance of the Guidelines in such circumstances. The first relates to whether the term ‘business relationships’, for the purposes of the Guidelines, is applicable to relations with investee companies, for example through a minority shareholding. The second issue concerns how adverse impacts caused or contributed by investee companies can be directly linked to the operations, products or services of an investor through that business relationship. These two issues are particularly important to clarify in circumstances where an investor has only a minority shareholder position. This latter and more complex issue is subject of another Note by the Secretariat.¹⁵

The Guidelines do not refer to financial investments in general or to minority shareholding in the particular, in the description of business relationships. They refer to “business partners, entities in the

¹¹ OECD Guidelines for Multinational Enterprises, Chapter I, paragraph 4

¹² The Guidelines are hence applicable to MNEs in any sector and to larger as well as small- and medium-sized enterprises. Governments adhering to the Guidelines wish to encourage the widest possible observance of the Guidelines (The Guidelines Preface, paragraph 6). This Note serves to confirm this. It is not intended to define more precisely any key terms of the Guidelines than what has been the result of the 2011 negotiations.

¹³ OECD Guidelines for Multinational Enterprises, Chapter II, Commentary on General Policies, paragraph 14

¹⁴ With regard to investments, it was already defined before the 2011 revision that investments are covered by the Guidelines:

“First, the Guidelines are an Annex of the OECD Declaration on International Investment and Multinational Enterprises. The fact that they are part of the Declaration and that oversight responsibility for them has been assigned by the Council to the CIME -- the body charged with responsibility for the Organisation’s work on investment and multinational enterprises – indicates the investment intent of the drafters of the instrument. (...)Third, the Guidelines have been developed in the specific context of international investment by multinational enterprises and their application rests on the presence of an investment nexus”

The Investment Committee (then the OECD Committee on International Investment (CIME)) issued a statement following its April 2003 meeting. The entire statement can be found online: <http://www.oecd.org/daf/inv/mne/scopeoftheguidelinesandtheinvestmentnexus.htm>

¹⁵ See Note on Due Diligence in the Financial sector: Adverse impacts directly linked to financial sector operations, products or services by a business relationship (2014)

supply chain and any other non-State or State entities directly linked to its business operations, products or services”, but not to “clients” or “investee companies” throughout the text.

The SFA research found that a number of financial institutions held the view that the Guidelines’ definition of business relationships does not include financial investments, as relationships with clients or investee companies are neither partnerships nor supply chains.¹⁶ The report stated: “A number of FI participants do not perceive the term ‘business partners’, particularly when described to include suppliers or sub-contractors, to comprise their clients or investee companies”.¹⁷ It also stated that “Depending on interpretations, clients or investee companies could arguably fall under the term ‘any other non-state or state entities directly linked to its business operations, products or services.’ However, the survey and interview process yielded no evidence to support this as an interpretation considered or supported by any of the FI study participants.”¹⁸ It should be noted however, and as stated in the SFA report, that this does not mean that FIs do not have strategies for due diligence in place for those clients and investee companies.

On minority shareholding in particular, Norges Bank (Norway’s Central Bank), the operational manager of the Government Pension Fund Global (the GPF), has argued in its letter to the Investment Committee (21 June 2013), that the Guidelines apply to companies in the GPF’s investment universe, but generally not to minority shareholders in relation to their investee companies.¹⁹ Further, in its letter, Norges Bank states that “the complexity of the relationships in the financial sector and the multitude of business models within this sector warrant a careful and thorough assessment of the proper functioning of the Guidelines within the sector. It is also NBIM’s opinion that the applicability of the Guidelines to minority shareholders warrants a separate and thorough assessment”.²⁰

The Dutch NCP’s and the Norwegian NCP’s statements on the involvement of respectively APG and NBIM with POSCO conclude that financial institutions and investors, including minority shareholders, are covered by the term ‘business relationships’.²¹ The Dutch NCP however also agreed with APG that further clarification of the applicability of the Guidelines in the day-to-day business of FIs is necessary.²² Further, the Office of the High Commissioner for Human Rights (OHCHR) is of the view that the UN Guiding Principles on Business and Human Rights apply to institutional investors holding minority shareholdings.²³

¹⁶ Sustainable Finance Advisory, “Environmental and Social Risk Due Diligence in the Financial Sector” (2013), p.52

¹⁷ Sustainable Finance Advisory, “Environmental and Social Risk Due Diligence in the Financial Sector” (2013), p.52

¹⁸ Sustainable Finance Advisory, “Environmental and Social Risk Due Diligence in the Financial Sector” (2013), p.52

¹⁹ Norges Bank (21 June 2013), “OECD Guidelines for Multinational Enterprises – Minority shareholders”, letter to the Chair of the OECD Investment Committee

²⁰ Norges Bank (21 June 2013), “OECD Guidelines for Multinational Enterprises – Minority shareholders”, letter to the Chair of the OECD Investment Committee.

²¹ Netherlands NCP (September 18th, The Hague), “Final statement ABP/APG - Lok Shakti Abhiyan, KTNC Watch, Fair Green and Global Alliance, Forum for Environment and Development” & Norwegian NCP (May 27th, Oslo), “Final statement: complaint from lok shakti abhiyan, Korean transnational corporations watch, fair green and global alliance and forum for environment and development vs. POSCO (South Korea), ABP/APG (Netherlands) and NBIM (Norway).”

²³ The issue of the applicability of the Guiding Principles on Business and Human Rights to minority shareholdings”, OHCHR (Geneva, April 26th 2013) (letter from OHCHR to OECD Watch)

One should bear in mind that the paragraphs in the Guidelines on business relationships are aligned with those of the UNGPs. Although the OECD Investment Committee provides formal clarification of the Guidelines, as a matter of international policy coherence it is considered desirable to align the interpretation of business relationships between the two instruments. To this end, reference may be made to the Interpretive Guide on the Corporate Responsibility to Respect Human Rights of the OHCHR.²⁴ This states 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.”²⁵ In its interpretive guidance regarding the applicability of the UNGPs by minority shareholders,²⁶ the OHCHR therefore concludes that (minority) shareholdings of institutional investors constitute a business relationship.

Related to the issue of minority shareholdings, the complexities around the different type of investments, investment strategies including passive investment and investments in index funds have been raised multiple times at the meetings of the WPRBC. The Secretariat realises that practical guidance regarding the observance of the Guidelines needs to be developed. An important question is how carrying out due diligence is adapted to a passive or index type of investment strategy and what a company is expected to do if it is made aware of an adverse impact caused or contributed by an entity in which it invests through an index fund. The Secretariat imagines that the multi-stakeholder proactive agenda project could consider, among other important matters, the expectations concerning practical approaches to due diligence in business relationships, such as between investors, their fund managers (in the case of passive investments) or entities offering an index product (in the case of index investments); and the corresponding expectations of due diligence that those entities may have with the companies in which they invest in, for example on behalf of the investor (in the case of passive investments) or with the companies they select to be part of the financial product (i.e. index) they are offering. Consideration will be needed on how to achieve due diligence of a complementary character by the various financial institutions involved in such investments in accordance with leverage and market characteristics.²⁷ The Note by the Secretariat on the terminology on ‘adverse impacts directly linked to operations, products or services by a business relationship’ in the context of the financial sector offers some initial considerations on these issues, for consideration in the proactive agenda project on the financial sector, which will work on the observance of the Guidelines for these types of investments with a view to provide practical guidance.

Conclusion

The understanding that the Guidelines are voluntary for enterprises has implications for the use of key terms such as “application” and “scope” of the Guidelines. It is precisely since the Guidelines are recommendations and not legally enforceable that open-ended descriptions of what is meant by the term

²⁴ “The Corporate Responsibility to Protect Human Rights: An Interpretive Guide”, OHCHR (UN, New York and Geneva, 2012)

²⁵ “The Corporate Responsibility to Protect Human Rights: An Interpretive Guide”, OHCHR (UN, New York and Geneva, 2012), p. 5

²⁶ “The issue of the applicability of the Guiding Principles on Business and Human Rights to minority shareholdings”, OHCHR (Geneva, April 26th 2013) (letter from OHCHR to OECD Watch).

²⁷ This may for instance imply that the investor initially focuses their due diligence on the fund manager or entity offering the index product, instead of directly on the companies it invests in; while the fund manager/entity offering the index product should carry out due diligence on the companies it includes in the index funds or in the investments undertaken on behalf of the investor. The Note on ‘Due Diligence in the Financial sector: Adverse impacts directly linked to financial sector operations, products or services by a business relationship’ considers this in more detail.

‘business relationships’ can be used. Since the Guidelines are recommendations, and adhering countries are committed to their widest possible observance, a precise definition is not necessary.²⁸

The Guidelines contain an expansive description of the term ‘business relationships’. Since the Guidelines operate with non-exhaustive descriptions of key terms, their possible use or “scope” is not limited by sector, to certain kinds of enterprises or to certain kinds of business relationships. A minority shareholding can therefore in principle be seen as a business relationship under the Guidelines, even if this is not spelled out in the text of the Guidelines itself.

Although observance of the Guidelines by enterprises is voluntary and not legally enforceable,²⁹ this does not reduce the expectations that the Guidelines should be observed. Financial institutions should consider the appropriate manner in which observance of the Guidelines could successfully be implemented in their business strategies.

As concerns the issue of financial institutions in their role as minority shareholders, including sovereign wealth funds and central banks, due regard must be paid to the sector-specific characteristics and practical and legal concerns and restrictions. This is important for our understanding of how the Guidelines could be observed within the financial sector. The issue of adverse impacts caused or contributed by investee companies being ‘directly linked’ to the operations, products or services of an investor through that business relationship will be part of a separate multi-stakeholder project. The Note by the Secretariat on the terminology on ‘adverse impacts directly linked to operations, products or services by a business relationship’ in the context of the financial sector offers some initial considerations on these issues, for consideration in the project.

²⁸ It is important to note this point, and to be clear about what we mean by “application”. The Guidelines do not “apply” in the legal sense of the term since they Guidelines are not legally enforceable. This understanding is reflected throughout the text of the Guidelines in the use of appropriate terms and the conscious avoidance of terms that might have unintended legal connotations, such as “obligations”, “compliance”, “violation”, “breach” or “duty”.

²⁹ OECD Guidelines for Multinational Enterprises, Chapter I, paragraph 1

mneguidelines.oecd.org

