

Inclusive Development International Submission to UN Working Group [Call for Input](#)

13 October 2023

1. Introduction

Inclusive Development International (IDI) is a U.S.-based non-profit organization that works to advance social, economic, and environmental justice by supporting communities around the world to defend their human rights and environment in the face of harmful corporate activities. Through research, casework and policy advocacy, we hold corporations and development agencies accountable to their human rights and environmental responsibilities and promote a more just and equitable international economic system.

We welcome the opportunity to respond to the UN Working Group on Business and Human Rights' Call for Input on the topic of Investors, ESG and Human Rights. Since 2020, Inclusive Development International has been conducting research into the systemic problems pervading the mainstream ESG investing industry,¹ with a focus on the role of ESG ratings firms and index providers.² We were motivated to conduct this research because **in the course of our 150+ investigations of harmful investment projects,³ we regularly find ESG-labeled funds invested in corporations causing and contributing to human rights violations.**

This not only demonstrates a failure of ESG investing to deliver what it promises to consumers, but more importantly, it creates a system of “ESG washing” that undermines efforts to hold companies accountable for breaching their human rights responsibilities. When a company implicated in human rights abuses is given a stamp of approval through high ESG ratings, investors and lenders are less likely to use their leverage over the company to compel action. As we have witnessed in our advocacy, this undercuts the ability of communities and human rights defenders to secure redress for corporate abuses. In addition to shielding companies from investor pressure to address human rights impacts, high ESG ratings conferred to abusive companies reward those companies with increased ESG investment.

After seeing this problem consistently in our cases, we sought to understand the mechanics of how ESG-labeled capital flows from investors to companies, and the decision-makers involved in directing that flow. Two key actors hold an enormous amount of influence in this process: 1) ESG index providers, the firms that create and maintain ESG-labeled indexes, which form the basis of many ESG-labeled funds, and 2) ESG ratings providers, the firms that assess and rate companies' ESG performance, which determine whether a company rates well enough to be included on an ESG index.⁴ There has been a high degree of consolidation of the ESG data industry, and the main firms dominating it typically offer both of these products and services.

¹ By “mainstream ESG investing industry,” we are referring to the biggest players in the industry, including the world's top asset managers and index providers that offer ESG-labeled products, as well as the top ESG ratings firms. This includes MSCI, FTSE4Good, and S&P Dow Jones Sustainability Indexes as ratings and index providers, and asset managers that rely upon those products for ESG funds, such as BlackRock and Vanguard. These mainstream ESG industry players differ from some smaller, more genuinely responsible investment firms that exist, such as [Adasina Social Capital](#).

² See Inclusive Development International, “Stop ESG Washing: Demanding that responsible investment does what it says,” <https://www.inclusivedevelopment.net/policy-advocacy/stopesgwashing/>. See also, David Pred and Natalie Bugalski, “Why ESG investing is bad for human rights and what we can do about it,”

<https://www.business-humanrights.org/es/blog/why-esg-investing-is-bad-for-human-rights-what-we-can-do-about-it/>

³ Inclusive Development International, “Following the Money to Justice,”

<https://www.inclusivedevelopment.net/following-the-money/>.

⁴ See [Annex 1](#), background information on ESG indexes.

While asset managers and other investors have received considerable scrutiny from the human rights community, **less attention has been paid to the human rights responsibilities of ESG ratings and index providers vis-à-vis companies that they rate and list in their indexes.** We commend the UN Working Group for including this issue within the scope of their Call for Input and we provide our views on this topic below.

Case examples: Companies involved in human rights abuses benefitting from ESG-labeled capital

As the Working Group rightly notes, the ESG industry is growing exponentially, with an “increasing use of data, indexes, ratings, benchmarking and funds labeled as being ESG.”⁵ In the majority of cases we work on, we find that even well-documented and widely publicized evidence of human rights impacts caused or contributed to by corporations is not adequately reflected in the ESG ratings provided by mainstream leading firms such as MSCI, FTSE Russell, and S&P Dow Jones. As such, companies with poor human rights performance are included on ESG-labeled indexes (often managed by the same handful of actors, MSCI, FTSE Russell and S&P⁶), which play a vital role in directing the flow of ESG investments. This is particularly true for passively managed ESG investments, which are fast-growing in popularity.⁷

In March 2022, IDI (along with ALTSEAN-Burma) published an exposé that demonstrates how, by using the label of “ESG,” asset managers raise enormous amounts of capital from unsuspecting investors seeking to invest with their values, and then invest that capital into funds with portfolio companies that are complicit in some of the most egregious human rights abuses and international crimes. Our exposé focused on the case study of ESG investment in Myanmar, detailing how “ESG-labeled funds have funneled billions into companies arming, funding, and legitimizing the Myanmar military, the perpetrator of the Rohingya genocide and a violent crackdown on the country’s pro-democracy movement.”⁸ These companies include weapons dealers that are arming the regime, tech firms serving the military-controlled national police force, and others that direct profits to the military, allowing it to surveil and violently crush dissent. The investigation found that funds carrying the ESG label held at least \$13.4 billion worth of shares in 33 companies linked with the Myanmar military. The funds were tied to various ESG indexes, on which the 33 companies were listed, based on opaque, inconsistent and flawed ratings and criteria.

Another example of the failure of ESG ratings to reflect grave human rights impacts is the reaction to the collapse of the Xe-Pian Xe-Namnoy hydroelectric power dam in Laos in 2018.⁹ The collapse,¹⁰ a result of negligent substandard construction,¹¹ killed dozens and left thousands homeless. Yet, the firm responsible for the dam’s construction, SK Group, has seen its MSCI ESG rating increase twice, from BBB to AA, since the disaster. In a discussion with MSCI, IDI was told that SK Group’s increased score was likely a result of the company’s improved climate change policies and focus on renewable energy. It appears that SK Group

⁵ UN OHCHR Working Group on Business and Human Rights, Call for Input: Investors, ESG and Human Rights. <https://www.ohchr.org/en/calls-for-input/2023/investors-esg-and-human-rights#:~:text=The%20Working%20Group%20seeks%20the.defenders%2C%20and%20Indigenous%20Peoples%20and>

⁶ Due to consolidation and verticalization over recent years, there are a handful of powerful industry players that dominate both the ESG ratings and ESG index industry.

⁷ See [Annex 1](#), background information on ESG indexes.

⁸ Inclusive Development International and ALTSEAN-Burma, “Myanmar ESG Files: How “responsible investment” is enabling a military dictatorship,” <https://www.inclusivedevelopment.net/myanmaresgfiles/>

⁹ Dustin Roasa, Thomson Reuters Foundation News, “How a Laos dam collapse exposes flaws in ESG investments,” <https://news.trust.org/item/20211216162549-rz27f/>

¹⁰ BBC News, “Laos dam collapse: Many feared dead as floods hit villages,” <https://www.bbc.com/news/world-asia-44935495>

¹¹ <https://www.cnn.com/2018/07/27/asia/laos-dam-collapse-construction-intl/index.html>

compensated for the reputational damage caused by the dam collapse by rebranding itself, and has reaped the rewards of a stellar ESG reputation, while victims of the dam collapse continue to lack restitution.

Many other companies that IDI has researched on request from communities adversely affected by their operations appear on ESG indexes and in funds that rely on them. For example:

- Glencore, which has been implicated in corruption, human rights abuses and environmental destruction in the DRC;¹²
- HeidelbergMaterials, which is alleged to have been involved in serious human rights abuses against Palestinians in Occupied Territories¹³ and to have disregarded Indigenous Peoples' rights to free, prior and informed consent in Indonesia;¹⁴
- Rio Tinto and Alcoa, who are behind a bauxite mine in Guinea that communities complain has grabbed land, polluted waterways and relocated villages without community consent¹⁵ and whose operations around the world have had many other devastating impacts, including, respectively, the destruction of Juukan Gorge, an ancient sacred Aboriginal site to access iron ore in Western Australia,¹⁶ and the alleged exposure of local residents to toxic chemicals from a smelter waste disposal dump in a small majority-Black town in North Carolina, U.S.A;¹⁷
- Arcelor Mittal, which jointly operates an iron ore mine in Mexico where human rights defenders and opponents of the project have been murdered, kidnapped, tortured and arrested;¹⁸
- TotalEnergies, a fossil fuel company that is co-developing oil fields and a pipeline in Uganda and Tanzania that would displace thousands and harm protected environments, water sources and wetlands;¹⁹

¹² Natural Resource Governance Institute, "Seismic Change Needed at Glencore Following a Decade of Corruption," July 2022, <https://resourcegovernance.org/articles/seismic-change-needed-glencore-following-decade-corruption>; International Corporate Accountability Roundtable (ICAR), "Accountable for corruption, but not for human rights abuse: the case of Glencore," August 2022, <https://icar.ngo/accountable-for-corruption-but-not-for-human-rights-abuse-the-case-of-glencore/>.

¹³ SOMO, "German cement giant involved in serious violations against Palestinians," February 2020, <https://www.somo.nl/german-cement-giant-involved-in-serious-violations-against-palestinians/>

¹⁴ Inclusive Development International, FIAN Germany, JMPPK, Complaint against HeidelbergMaterials to the German National Contact Point for the OECD, https://www.inclusivedevelopment.net/wp-content/uploads/2020/12/Complaint-to-German-NCP-Regarding-HeidelbergCement_9_Sept2020_Redacted-for-pub.pdf

¹⁵ Inclusive Development International, "Thirteen Guinean villages lodge complaint against World Bank for financing destructive bauxite mine," March 2019, <https://www.inclusivedevelopment.net/ifc-campaigns/thirteen-guinean-villages-lodge-complaint-against-world-bank-for-financing-destructive-bauxite-mine/>

¹⁶ "Executives to Step Down After Tio Tinto Destroys Sacred Australian Sites," NYT, September 11, 2020. <https://www.nytimes.com/2020/09/11/business/rio-tinto-indigenous-sites.html>

¹⁷ "Dishonorable discharge: Runoff from a former industrial site is contaminating an important NC lake." NC Newline November 22, 2022. <https://ncnewline.com/2022/11/22/dishonorable-discharge-runoff-from-a-former-industrial-site-is-contaminating-an-important-nc-lake/>

¹⁸ Business and Human Rights Resource Centre, "Mexico: Environmental Law Alliance Worldwide denounces jailing of indigenous rights defender opposing mining activity of Peña Colorada of Ternium & ArcelorMittal," September 2015, <https://www.bhrrc.org/en/latest-news/mexico-environmental-law-alliance-worldwide-denounces-jailing-of-indigenous-rights-defender-opposing-mining-activity-of-pe%C3%B1a-colorada-of-ternium-arcelormittal-companies-respond/>; Proceso, "Presidente de la Red Jalisciense de Derechos Humanos denuncia amenazas de Muerte," October 2021 <https://www.proceso.com.mx/nacional/2021/10/5/presidente-de-la-red-jalisciense-de-derechos-humanos-denuncia-amenazas-de-muerte-273327.html>; US State Department, Mexico Human Rights Report, 2015 <https://2009-2017.state.gov/documents/organization/253239.pdf>.

¹⁹ See StopEACOP Campaign, compilation of reports on the project's risks, <https://www.stopeacop.net/publications>.

- JSW Steel, which has allegedly grabbed land from farming and fishing communities in order to develop a massive steel facility in India.²⁰

2. Response to UN Working Group Questions

Below we respond to several of the questions posed in the Working Group’s Call for Input.

General Question 1: What do you understand Environmental, Social, and Governance (ESG) in finance to mean? How are human rights standards and frameworks considered by investors, if at all, in ESG?

One of the fundamental flaws of the mainstream ESG investing industry is the disconnect between how the concept of ESG is advertised to and understood by consumers, and how it is defined and implemented in practice. ESG products are most often advertised to the public as an initiative grounded in ethics, offering a way to invest according to one’s values and avoid investing in companies with negative social and environmental impacts.²¹ In practice, however, ESG constitutes a morally neutral set of risk assessments designed to maximize investor returns and minimize environmental, social and governance related risks to investors. In other words, mainstream ESG ratings do not seek to measure a company’s impact on society and the environment; rather, they seek to assess how ESG-related factors pose material risk to a company’s share price and profitability.²² In this way, consumers have been significantly misled.²³

Based on our investigation, ESG scores calculated by the industry’s major ESG ratings firms fail to adequately reflect a company’s performance in relation to human rights standards. There are several reasons for this.

- **ESG scores measure financial materiality:** Because ESG ratings are conducted from the financial materiality perspective described above, any human rights impact associated with a company’s operations will only affect the company’s rating if the human rights impact presents a financially material risk to the company itself. Oftentimes, for human rights impacts to create material risk, those harmed must have engaged in an advocacy strategy, through blockades, litigation, the media or other advocacy, that is viewed (by the ratings agencies) as threatening to the company’s profits or share value. In effect, this means that the vast majority of corporate human rights abuses are not reflected in a company’s ESG score. This is at odds with a human rights-based approach.
- **Amalgamated E, S, and G scores obfuscate human rights impacts:** Even where a human rights impact is factored into the “S” of a company’s ESG score, it rarely significantly impacts a company’s overall ESG rating. This is because the dominant approach to ESG rating amalgamates the E, S and G factors into one overall score. This obfuscates salient human rights impacts and allows a company to easily offset a negative “S” score (caused by poor human rights performance) with unrelated

²⁰ FIAN International, Universal Periodic Review for India, 2022,

[https://www.fian.org/files/files/UPR_India2022_FIAN_International\(1\).pdf](https://www.fian.org/files/files/UPR_India2022_FIAN_International(1).pdf)

²¹ For example, MSCI’s CEO has described the company’s “mission” as, “help[ing] investors build better portfolios for a better world.” <https://www.fool.com/earnings/call-transcripts/2021/07/28/msci-msci-q2-2021-earnings-call-transcript/>. Vanguard’s Acorns app similarly describes ESG as an opportunity for individuals to “invest for good.” <https://www.acorns.com/esg-investing/>

²² See Bloomberg, “The ESG Mirage,” December 2021. The report states, “[ESG] ratings don’t measure a company’s impact on the Earth and society. In fact, they gauge the opposite: the potential impact of the world on the company and its shareholders.” <https://www.bloomberg.com/graphics/2021-what-is-esg-investing-msci-ratings-focus-on-corporate-bottom-line/>

²³ See Myanmar ESG Files report, in particular the sections entitled “Duping the American Public” and “How ESG Funds are Made.” See also, Harvard Business Review, “ESG Investing Isn’t Designed to Save the Planet,” August 2022.

<https://hbr.org/2022/08/esg-investing-isnt-designed-to-save-the-planet>

actions, such as the adoption of a new emissions reduction policy.²⁴ This is inconsistent with a human rights-based approach, which requires due diligence and action to address all human rights impacts.

- **ESG scores grade on a curve:** Many ESG ratings firms assess a company’s performance only in relation to its industry peers, allowing the best performers in a given industry to score highly relative to their peers—even where a company’s human rights performance is egregious when assessed in absolute terms. This creates a distorted picture of corporate performance and leads to the “best of the worst” appearing on ESG funds. This is evidenced by the numerous mining companies that appear on ESG indexes and funds, including Glencore, Arcelor Mittal and Rio Tinto, which are discussed above.
- **Overreliance on corporate self-reporting and media sources, and “decaying” controversies:** Many ESG ratings firms rely primarily on corporate self-reporting to determine a company’s ESG scores. Recent reporting by the Financial Times emphasizes the severe conflict of interest that pervades the ESG ratings industry, where companies and investors can improperly influence ratings.²⁵ Beyond corporate self-reporting, ESG ratings firms rely upon media sources to identify “controversies,” which are factored into the amalgamated ESG scores. However, these controversies are only identified when they are reported upon in the news or other easily located public sources, and are given more weight depending upon the severity of the controversy (i.e. the level of reputational—and therefore financial—risk posed to the company by the incident). Because many corporate human rights abuses are not captured in mainstream news outlets, and/or do not rise to the level of financial materiality, they do not meaningfully impact a company’s ESG score. In addition, controversies are often allowed to “decay” over time, meaning that the weight of a controversy will decrease if no new incidents appear in the news or other public sources. As the news cycle moves on from a controversial human rights incident, a company’s ESG score will recover from the “controversy,” regardless of whether the human rights impact has been remediated and the victims continue to suffer harm.

For a deeper exploration of these issues, see our [Myanmar ESG Files](#) report and submission to the European Securities and Markets Authority ([Annex 3](#)).

General Question 4: What responsibilities and capacity do ESG index and data providers have regarding the assessment of adverse human rights and environmental impacts, and how can ESG indexes and research products be improved to align with the UNGPs approach?

(note: this section also relates to Questions 3 and 4 regarding corporate responsibility to respect human rights; and Question 2 regarding best practice.)

As described above, the ESG scores given to companies by mainstream ratings firms largely fail to adequately capture and reflect adverse human rights impacts associated with a company’s operations. For many of the industry’s dominant players, including S&P Dow Jones, FTSE Russell and MSCI, these flawed ESG ratings

²⁴ This is illustrated in practice in the XPXN dam collapse case, in which SK Group saw its ESG score increase despite having caused or contributed to egregious human rights impacts in Laos. According to MSCI, any negative bearing to its ESG score caused by the dam collapse was likely offset (and outweighed) by the company’s adoption of a new climate-related policy.

²⁵ Financial Times, Kenza Bryan, “ESG ratings: whose interests do they serve?” October 3, 2023. <https://www.ft.com/content/fbe10867-fca1-4887-b404-9f9e301e102e>

are then used to create ESG indexes, which are relied upon by investors and asset managers to build funds deceptively marketed as “sustainable.”²⁶

ESG ratings and index providers are powerful financial actors that play a vital role in directing enormous sums of capital towards corporations causing and contributing to human rights abuses.²⁷ Below we set out our analysis of the human rights responsibilities of ESG index providers and ratings firms. Our conclusion is that these actors have a business relationship with the companies they rate and include in their indexes, and therefore have due diligence responsibilities, including the responsibility to use their leverage where they identify that these companies are causing or contributing to adverse human rights impacts.

Establishing the existence of a “business relationship” as defined by the UN Guiding Principles

Under the UN Guiding Principles, companies have a responsibility to “prevent or mitigate adverse impacts that are directly linked to their operations, products or services by their business relationships.”²⁸ Under the UNGPs, “business relationships” are not limited to a company’s direct contractual relationships with business partners, but also include relationships with entities throughout its value chain.²⁹ According to past OHCHR advice, “the commentary to Guiding Principle 13 suggests an expansive interpretation of the scope of companies and business relationships covered.”³⁰ It is widely recognized in supply chain contexts, for instance, that business relationships extend throughout a company’s supply chain, even where the relationship exists through multiple intermediary entities.³¹ In the financial sector, it has also been established that under both the OECD Guidelines and UNGPs, a business relationship may exist between a financial institution and an investee company, including through “multiple tiers of business relationships.”³²

While ESG rating and index firms may not enter into a direct contractual relationship with the companies that appear on their indexes, they maintain a business relationship with those companies. The companies constitute an essential component of the products and services sold by ESG firms and are therefore an

²⁶ For a more detailed description of how investment indexes operate, and how ESG indexes are created and maintained, see [Annex 1](#).

²⁷ Ibid.

²⁸ UNGP 13(b).

²⁹ Official commentary to UNGP13(b) states, “For the purpose of these Guiding Principles a business enterprise’s [...] ‘business relationships’ are understood 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.”

According to the OECD, “‘Linkage’ is defined by the relationship between the adverse impact and the enterprise’s products, services or operations through another entity (i.e. business relationship).

‘Directly linked’ is not defined by direct contractual relationships, for example ‘direct sourcing.’” See OECD Due Diligence Guidance for Responsible Business Conduct (2018), Annex, Question 29.

<http://mneguidelines.oecd.org/OECD-Due-Diligence-Guidance-for-Responsible-Business-Conduct.pdf>

³⁰ OHCHR response to request for advice regarding the application of the UN Guiding Principles on Business and Human rights where private sector banks act as nominee shareholders,

<https://www.ohchr.org/Documents/Issues/Business/finance-2021-response-nominee-shareholders.pdf>

³¹ OECD provides the following example of a directly linked relationship: “, if an enterprise sources cobalt mined using child labour which is then used in its products the enterprise can be directly linked to the adverse impact (i.e. child labour). In this case, the enterprise did not cause or contribute to the adverse impact itself, but nevertheless there still can be a direct link between the enterprise’s products and the adverse impact through its business relationships with the entities involved in its sourcing of the cobalt (i.e. with the smelter, minerals trader, and mining enterprise using child labour).” In this example, the end user’s directly linkage to the impact extends through multiple intermediary relationships. See OECD Due Diligence Guidance for Responsible Business Conduct (2018), Annex, Question 29. <http://mneguidelines.oecd.org/OECD-Due-Diligence-Guidance-for-Responsible-Business-Conduct.pdf>

³² OHCHR response to request for advice regarding the application of the UN Guiding Principles on Business and Human rights where private sector banks act as nominee shareholders,

<https://www.ohchr.org/Documents/Issues/Business/finance-2021-response-nominee-shareholders.pdf>; See also OHCHR response regarding the issue of the applicability of the Guiding Principles on Business and Human rights to minority shareholdings,

<https://www.ohchr.org/Documents/Issues/Business/LetterSOMO.pdf> and OECD Guidance on Responsible Business Conduct in the Financial Sector, <https://mneguidelines.oecd.org/rbc-financial-sector.htm>.

integral part of the ESG firms' value chain. The ESG ratings firms solicit information from the companies they score, and those companies provide vital information (in the form of surveys, self-assessments, and other ESG reporting formats) to the ratings firm which allow them to score companies and produce ESG indexes. Furthermore, the relationship between ESG firms and investee companies is mutually beneficial, generating value for both parties. When an ESG firm assigns a high enough rating to include a company on an ESG index, it imbues reputational benefits and facilitates access to significant capital for that company, while simultaneously earning profits itself by providing the rating and index maintenance service to investors.

The ESG firms that score companies and include them on their ESG-labeled indexes have a business relationship with those companies, which constitute an integral part of their value chain, and would therefore be directly linked to the human rights abuses to which those companies may have caused or contributed.

Human rights responsibilities that flow from that business relationship: due diligence and use of leverage

This business relationship creates a human rights responsibility for the ratings firms and index providers to conduct human rights due diligence to identify human rights risks and impacts to which they may be directly linked. Where risks or impacts are identified, the ratings firms and index providers have a responsibility to use their leverage with companies that appear on their indexes to prevent or mitigate those impacts, including by downgrading the implicated companies' ratings and excluding them from their ESG indexes if the companies fail to act.

Arguably all index providers (including those that construct non-ESG indexes) maintain business relationships with the companies that appear on their indexes, by nature of their value chain and service, which entails directing investments towards those companies. However, the roles and responsibilities of ESG and non-ESG index providers to address human rights risks and impacts to which they are linked through those business relationships diverge in important ways.

ESG ratings and index firms actively market their products and services to investors as important tools that investors can rely upon when conducting their own human rights due diligence. Our organization has extensive experience engaging with investors exposed to significant human rights impacts in their portfolios, many of which have informed us that they rely—in part or in whole—upon the ESG ratings of companies to conduct human rights due diligence. A high score on ESG performance and inclusion in an ESG index creates the public perception of a “stamp of approval” with respect to social and environmental issues. This approval is used by companies to advance their business and attract investment; and is relied upon by investors seeking to fulfill their own human rights responsibilities under the Guiding Principles and OECD Guidelines. By actively representing themselves in this way, ESG firms have created a public expectation and arguably a duty of care to meet minimum standards of reliability and effectiveness.

Additionally, ESG firms hold considerable leverage over the companies that they rate and include on their ESG indexes, which conventional index providers do not hold. The ESG index creation methodology enables the index creator to include or exclude certain companies from the ESG index based upon the companies' ESG performance. In the cases of MSCI, FTSE Russell and S&P Dow Jones Indices, which produce the ESG ratings that underlie the ESG indexes they create, the firms have significant discretion over which firms are included, and therefore significant leverage over the companies that want to be added to or remain on the ESG index. The leverage is derived not only from the ability to facilitate or restrict investment in those companies, but also from the ability to bestow reputational benefit upon the companies that are included in an ESG index. In a meeting with MSCI staff in December 2021, a senior representative acknowledged that

the firm holds leverage over companies on its ESG indexes, stating, “Companies often come to us asking what they need to do to stay on an ESG index.”

The index provider FTSE Russell recently published a research paper on the topic of leverage and the role of index firms in influencing company behavior in instances of passive investing.³³ A key finding of the paper is that passive investors can “outsource to index providers the work involved in setting [ESG] standards and ensuring that they are met by investee companies.” The paper goes on to say, “by developing indexes with clear and transparent rules on sustainability issues, and engaging broadly with investee companies to ensure compliance, index providers can do much of the heavy lifting of engagement on behalf of passive index investors,” and that index providers can “reward or penalize companies,” by removal from the index or through index over and under-weighting.³⁴ The paper details how the firms responsible for ESG index design and calculation can effectively engage with investee companies and use their leverage to incentivize companies to “achieve real world improvements in corporate sustainability performance.” These incentives, according to FTSE, can include both reputational benefits, if there is visibility in index selection, as well as through greater investment flows.³⁵

One academic research project into this area, conducted by the University of Edinburgh Business School, found that engagement by FTSE and the threat of expulsion from the FTSE4Good ESG index doubled the probability that a firm failing to meet environmental criteria for inclusion on the index would comply within a three year period.³⁶ Another study from the University of Nottingham found that companies adjusted their behavior in response to the ESG index criteria, and that engagement based on the index inclusion criteria was a catalyst for internal sustainability champions within investee companies to advance their agenda around sustainability issues.³⁷

One example of an ESG ratings and index firm using their leverage to address human rights risks and impacts occurred in 2021, when S&P Dow Jones Indices removed Adani Ports, India’s largest port operator, from its Dow Jones Sustainability Indices. The decision was triggered by “heightened risks to the company regarding their commercial relationship with Myanmar’s military, who are alleged to have committed serious human rights abuses under international law,” the index provider said in a statement.³⁸ Adani Ports had plans to construct a shipping container terminal on land leased from a Myanmar military-controlled company, as documented by the UN Fact Finding Mission.³⁹ Following the coup in Myanmar, Adani Ports reportedly paid over \$100 million to the military company, providing a significant source of revenue for the military junta.⁴⁰ Following the lowering of its ESG score and public removal from S&P’s ESG index, Adani Ports’ share price

³³ FTSE Russell, “Achieving scale in active ownership and engagement through index investing,” https://content.ftserussell.com/sites/default/files/achieving_scale_in_active_ownership_and_engagement_through_index_investing_final.pdf?ga=2.58682530.948067829.1639060060-781965199.1634204423

³⁴ Ibid., p 7.

³⁵ Ibid., p 3.

³⁶ Ibid., p 9.

³⁷ Ibid.

³⁸ S&P Dow Jones Indices, “Removal of Adani Ports and Special Economic Zone from the Dow Jones Sustainability Indices,” https://www.spglobal.com/spdji/en/documents/indexnews/announcements/20210412-1355163/1355163_djsi-adani-20210412.pdf

³⁹ UN Human Rights Council, “The economic interests of the Myanmar military, Independent International Fact-Finding Mission on Myanmar,” https://www.ohchr.org/Documents/HRBodies/HRCouncil/FEM-Myanmar/EconomicInterestsMyanmarMilitary/A_HRC_42_CRP_3.pdf

⁴⁰ Australian Centre for International Justice and Justice for Myanmar, “Port of Complicity: Adani Ports in Myanmar,” <https://acij.org.au/wp-content/uploads/2021/03/Port-of-Complicity-Report-FINAL-High-Resolution.pdf> and The Maritime Executive, “Adani Ports may abandon Myanmar terminal project over sanctions risk,” <https://www.maritime-executive.com/article/adani-ports-may-abandon-myanmar-terminal-project-over-sanctions-risk>

decreased sharply. Shortly thereafter, the company publicly announced it would cancel the proposed port project and end its involvement in Myanmar.⁴¹ This incident illustrates how an ESG index provider can meet its human rights responsibilities by exercising its considerable leverage to address human rights concerns.

How ESG index and ratings products can be improved to align with the UNGPs approach

ESG ratings and index firms can implement several reforms to ensure their products adequately capture and reflect human rights concerns, and are more aligned with a human rights-based approach:⁴²

1. **ESG research and ratings must go beyond company self-reporting and corporate policies, to assess actual impact.** Under the dominant methodology for ESG ratings, corporate self-reporting and policies hold more weight than testimony from rights-holders, including workers and communities affected by a company's operations. This is problematic, as companies are highly incentivized to portray an unrealistic account of their human rights risks and negative impacts. Establishing a regulated, independent auditing and assurance system that prioritizes the perspectives of rights-holders could be part of the solution. (To be credible, the system would have to, inter alia, require auditing firms to be selected and commissioned by ESG research and ratings firm, and not the company being audited.) Such an auditing system could also be used to verify the accuracy of corporate ESG disclosures and identify any omissions (with the auditors themselves subject to penalties for failures of due diligence).
2. **ESG research and ratings firms should prohibit the use of amalgamated ESG ratings, which obfuscate salient human rights and environmental impacts and lead to greenwashing.** As described in response to Question 1, this is a common occurrence that prevents human rights harms from being adequately reflected in ESG ratings. Ratings firms should break down ESG scores into separate and distinct categories.
3. **ESG ratings should assess a company's performance in each category in absolute terms.** All companies should be assessed against the same global standards of responsible business conduct, rather than graded on a curve against industry peers, as is the current practice (see response to Q1).
4. **ESG ratings firms should ensure that the ratings of any company that has caused or contributed to serious human rights violations are downgraded to such an extent that it will be automatically excluded from ESG indexes and funds.** Fundamentally, companies complicit in human rights harms should not receive ESG-labeled investment. The downgraded scores should remain in place until the harm has been remediated. The score should not be improved on the basis of corporate policy development, or due to a lack of public "controversy" around the harm.
5. **ESG ratings and index firms should establish effective human rights grievance mechanisms at ESG firms to receive complaints related to companies that are rated and listed on ESG indexes.** This would enable rights-holders to communicate directly with the ESG firms about the human rights performance of relevant companies. Where there is credible evidence that a company is

⁴¹ Reuters, "India's Adani Ports scraps Myanmar container terminal plans," <https://www.reuters.com/world/india/indias-adani-ports-says-it-will-exit-myanmar-investment-2021-10-27/>

⁴² These recommendations are further reflected on our [website](#), in a [blog](#) published by IDI co-founders, and in our submissions to both the SEC and ESMA (Annex 2 and 3).

implicated in serious violations, index providers should collaborate with asset managers to use their leverage to demand remedial action and remove companies that fail to repair the harms.

Questions related to the state duty to protect human rights and corporate responsibility to respect human rights:

Question 1: What State, regional, and international mechanisms and regulations exist to promote or restrict investment/financing using an ESG approach that takes human rights into account and how do they align with the UNGPs? How do these mechanisms and regulations promote or inhibit business respect for human rights consistent with the UNGPs?

Question 2: To what extent do current regulations ensure adequate information and disclosure for investors adopting an ESG approach to understand human rights impacts of businesses?

Question 3: How can States encourage and regulate accurate communication of ESG practices by businesses and investors to prevent misleading or unsubstantiated claims regarding respect for human rights?

(note: this section also relates to Questions 3 and 4 regarding corporate responsibility to respect human rights)

While some encouraging initiatives are underway to regulate corporate ESG disclosure and reporting,⁴³ we are concerned with the reliance on financial materiality as the basis for sustainability-related disclosure frameworks.⁴⁴ This framing focuses exclusively on sustainability-related risks and opportunities to enterprise value. Instead regulators should require companies to report on all salient human rights risks and impacts regardless of whether they are viewed as financially material.

The Securities and Exchange Commission has proposed rules aimed at requiring funds to disclose additional information about the ESG methodologies and restricting the use of misleading ESG labels in fund names.⁴⁵ This would increase transparency on ESG investing approaches and introduce basic safeguards against false advertising of funds, but the proposed rules do not go far enough.⁴⁶

We are concerned that the majority of regulatory efforts thus far have been focused exclusively on the activities of investors while, by contrast, the ESG research, data, ratings and index providers whose flawed methods underpin the entire ESG investing ecosystem, are not subject to any regulatory oversight.⁴⁷ To bring

⁴³ See, for instance, the GRI-led European Sustainability Reporting Standards (ESRS) and the ISSB-led Sustainability Disclosure Standards.

⁴⁴ This is a concern for the ISSB Sustainability Disclosure Standards, which has thus far explicitly rejected the concept of double materiality. See [Annex 4](#) for our comments on the ISSB standards, and in particular paragraph 2 and footnotes 1-2, where we address the concept of double materiality. We note that the double materiality approach has been adopted by the Global Reporting Initiative (GRI) and the European Financial Reporting Advisory Group (EFRAG) in the construction of the European Sustainability Reporting Standards (ESRS). See, e.g. Global Reporting Initiative, <https://www.globalreporting.org/media/r2oojx53/gri-perspective-the-materiality-madness.pdf>.

⁴⁵ See [Annex 2](#) on SEC Proposed Rules.

⁴⁶ Ibid. See also, ESG Investor, [Why the SEC's Proposed Rules Won't Bring the Change We Need](https://www.esginvestor.net/why-the-secs-proposed-rules-wont-bring-the-change-we-need/),

⁴⁷ The International Organization of Securities Commissions has recently called upon security regulators to expand their mandates to regulate these entities. Progress has been made in the EU and UK in this regard, while the US SEC lags behind. See, <https://www.responsible-investor.com/iosco-esg-ratings-and-data-need-regulatory-oversight-to-increase-trust/> and <https://www.ft.com/content/97dd3144-dadb-452f-9a65-088a841ad7b1>

the ESG investing industry into greater alignment with the requirements of the UNGPs, a more fundamental reform of the industry is needed.

Importantly, we are beginning to see some positive movement towards regulation of these actors, with regulators and legislators in some jurisdictions more closely considering the accuracy, transparency and potential conflict of interests present in the ESG ratings sector. European lawmakers have introduced a proposed law that would compel ESG rating agencies to separate from their consultancy arms (which currently pose conflict of interest concerns), disclose more information about their methodologies, and formally register with authorities.⁴⁸ The Indian securities regulator has introduced similar efforts towards transparency of ratings methodologies.⁴⁹ While these are positive steps, more is needed to bring the activities of ESG ratings and index firms into meaningful alignment with the UNGPs.

To see IDI's more detailed recommendations to security regulators, see Annex 2 and 3, as well as [this blog](#).

Questions related to the corporate responsibility to respect human rights:

See above.

Questions related to access to remedy:

State-based question 2: Please provide examples of cases submitted to State-based judicial and/or non-judicial mechanisms regarding investors in the context of business-related human rights and environmental abuses. How effective are these in providing remedies to the victims and how can they be improved?

Non-state based question 2: What measures and mechanisms, including grievance mechanisms, should be provided at the investment-level that enable individuals or communities affected by the business in which the investor has invested (e.g. the portfolio company) to report adverse human rights impacts to the investor and seek effective remedy for human rights and environmental abuses? How effective are these in providing remedies to the victims? Please provide examples of business or industry association actions in this area.

IDI has supported communities to bring complaints regarding adverse human rights or environmental impacts to numerous state-based and non-state-based non-judicial grievance mechanisms (NJGMs), particularly through the OECD National Contact Point system⁵⁰ and through the independent accountability mechanisms (IAMs) of development finance institutions.⁵¹ One of the NCP complaints concerned a lender

⁴⁸ European Commission, "Proposal for a Regulation of the European Parliament and of the Council on the transparency and integrity of Environmental, Social and Governance (ESG) rating activities," June 13, 2023.

<https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52023SC0204>

⁴⁹ Financial Times, Kenza Bryan, "ESG ratings: whose interests do they serve?" October 3, 2023.

<https://www.ft.com/content/fbc10867-fca1-4887-b404-9f9e301e102e>

⁵⁰ EC and IDI vs. Australia and New Zealand Banking Group (Australian NCP)

<https://www.oecdwatch.org/complaint/ec-and-idi-vs-australia-and-new-zealand-banking-group/>; IDI, EC and LICADHO vs.

Bonsucro (UK NCP) <https://www.oecdwatch.org/complaint/idi-ec-and-licadho-v-bonsucro/>; IDI et al. vs. Marsh (US NCP)

<https://www.oecdwatch.org/complaint/inclusive-development-international-et-al-vs-marsh/>; IDI and FIAN Germany vs.

HeidelbergCement (German NCP) <https://www.oecdwatch.org/complaint/idi-fian-germany-vs-heidelbergcement/>.

⁵¹ Inclusive Development International currently has six open cases at the Compliance Advisor Ombudsman (CAO) of the International Finance Corporation (IFC) <https://www.cao-ombudsman.org/cases> and one open case at the Independent Complaints

(the case against ANZ at the AusNCP).⁵² All the complaints to IAMs concern failures of the development finance institutions to conduct adequate due diligence and supervision of their investments. Of these, some involve direct loans to project developers,⁵³ and several have involved financial intermediaries of the development bank, including commercial banks⁵⁴ and in one case, a private equity fund.⁵⁵

In our extensive experience supporting communities to engage in non-judicial processes to secure remedy for corporate human rights harms, we have found that, by and large, these mechanisms are ill-equipped to enable access to remedy, and often lack the mandate or willingness to compel corporate human rights abusers to fully remediate harms. Nonetheless, given the current lack of effective judicial avenues through which victims can pursue corporate accountability for human rights harms, these existing NJGMs are critical forums through which victims *can*, when used as one component of a broader multi-pronged advocacy strategy, secure remedy. Indeed, several of the cases IDI has brought to NJGMs have resulted in tangible remedial outcomes for communities, including one of the first known instances of compensatory remedy provided by a commercial bank for harms caused by its client.⁵⁶

We have made extensive submissions over the years to development finance institutions, IAMs and the OECD on how to improve their NJGMs and would be pleased to discuss these recommendations further with the UN Working Group, if helpful. We were also consulted as part of an expert advisory group on the establishment of the first human rights-aligned grievance mechanism by a commercial bank, adopted by ANZ as a result of a complaint we brought to the Australian NCP.⁵⁷ In our view, all financial institutions—including banks and investors—should follow suit in adopting similar operational-level grievance mechanisms.

However, given that many of the ESG industry's systemic issues originate with the flawed practices of ESG ratings firms and index providers as well as the fact that these actors lack any meaningful regulatory oversight, we believe it is absolutely critical that ESG ratings and index firms establish their own UNGP-aligned independent operational-level grievance mechanisms. This would enable external stakeholders to communicate directly with ESG ratings firms and indexes, so that actual human rights performance can be reflected in corporate ESG ratings, and companies causing or contributing to harms can be removed from

Mechanism (ICM) shared by DEG, Proparco and FMO

<https://www.proparco.fr/en/ressources/icm-complaint-21-001-preliminary-review-report>.

⁵² EC and IDI vs. Australia and New Zealand Banking Group (Australian NCP)

<https://www.oecdwatch.org/complaint/ec-and-idi-vs-australia-and-new-zealand-banking-group/>.

⁵³ Complaint to the CAO regarding Compagnie des Bauxites de Guinée

<https://www.cao-ombudsman.org/cases/guinea-cbg-01-sangaredi>

⁵⁴ Complaint to the CAO regarding Rizal Commercial Banking Corporation

<https://www.cao-ombudsman.org/cases/philippines-rizal-commercial-banking-corporation-rcbc-01>; Complaint to the CAO regarding Nedbank <https://www.cao-ombudsman.org/cases/guinea-nedbank-tier-ii-01kintinian>; Complaint to the CAO regarding Postal Savings Bank of China <https://www.cao-ombudsman.org/cases/indonesia-financial-intermediary-01>.

⁵⁵ Complaint to the CAO regarding Dragon Capital Group,

<https://www.inclusivedevelopment.net/wp-content/uploads/2014/02/FF-on-IFC-Dragon-Capital-and-HAGL-rubber-plantations.pdf>.

⁵⁶ Inclusive Development International, “Securing compensation for ANZ-backed land grab,”

<https://www.inclusivedevelopment.net/cases/cambodia-sugarcane-land-grabs/>; see also Inclusive Development International, “ANZ payment to displaced Cambodian families brings landmark human rights case to a close,” <https://www.inclusivedevelopment.net/equator-banks/anz-payment-to-displaced-cambodian-families-brings-landmark-human-rights-case-to-a-close/>.

⁵⁷ Inclusive Development International, “ANZ launches human rights grievance mechanism in a first for the global banking sector,”

<https://www.inclusivedevelopment.net/equator-banks/anz-launches-human-rights-grievance-mechanism-in-a-first-for-the-global-banking-sector/>. See also ANZ Bank, Human Rights Grievance Mechanism Framework, <https://www.anz.com.au/content/dam/anzcomau/documents/pdf/aboutus/anz-grievance-mechanism-framework-nov2021.pdf>

ESG indexes as appropriate. This is a critical component of the human rights responsibilities of these ESG actors; yet we are not aware of any such efforts currently underway.

Questions related to good practices:

Question 2: Are there any specific recommendations to States, businesses (including investors), civil society, UN bodies and National Human Rights Institutions that would assist in ensuring that investors act compatibly with the UNGPs?

See above.