POLICY BRIEF

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Leveraging ESG for promoting Responsible Investment and Human Rights

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ABSTRACT

The growing integration of Environmental, Social, and Governance (ESG) principles into investment frameworks and corporate reporting reflects a heightened recognition of the interplay between business operations and human rights. This Policy Brief examines the evolution of ESG investing, particularly its role in promoting responsible investment and embedding human rights considerations throughout business practices and supply chains. While ESG frameworks hold promise for enhancing corporate accountability and sustainability, challenges persist in effectively linking ESG criteria with human rights standards. It also shows that disparities in ESG reporting criteria and methodologies, compounded by a lack of shared understanding, pose obstacles to meaningful engagement with human rights responsibilities. The Policy Brief also delineates between ESG investing and reporting, highlighting distinct objectives and practices. While ESG investing aims to mitigate financial risks associated with environmental, social, and governance factors, ESG reporting focuses on evaluating firms' exposure to ESG risks. The Policy Brief underscores the limitations of ESG frameworks in identifying and preventing human rights impacts comprehensively, emphasising the need for complementary measures such as mandatory human rights due diligence. Finally, the paper considers the need for greater coherence and consistency in ESG frameworks to foster responsible investment, promote human rights, and advance sustainable development goals.

KEYWORDS: *ESG (Environmental, Social, Governance), Investment frameworks, Corporate reporting, Human Rights, Responsible Investment, Corporate accountability, Sustainability*

La prise en compte croissante des critères environnementaux, sociaux et de gouvernance (ESG) dans les stratégies d'investissement et les rapports d'entreprise reflète une reconnaissance accrue de l'interaction entre les activités commerciales et les droits de l'homme. Le présent rapport sur les politiques examine l'évolution des critères ESG, en particulier leur rôle dans la promotion de l'investissement responsable et la prise en compte des considérations relatives aux droits de l'homme dans les pratiques commerciales et les chaînes d'approvisionnement. Si les cadres ESG sont prometteurs dans l'optique d'encourager les entreprises à plus de responsabilité et de durabilité, des difficultés persistent pour relier efficacement les critères ESG aux normes en matière de droits de l'homme. Le rapport montre également que les disparités dans les critères et les méthodologies utilisées en matière de reporting ESG, aggravées par un manque de compréhension commune, constituent des obstacles à un engagement significatif des entreprises en faveur des droits de l'homme. Il établit également une distinction entre l'investissement ESG et le reporting ESG, en mettant en évidence des objectifs et des pratiques distincts. Alors que l'investissement ESG vise à atténuer les

KEY MESSAGES

"ESG factors are broadly related to responsible investment, but they may not have a direct impact on the sustainable development or achievement of social goals in developing countries."

"ESG ratings can be a tool to support businesses' efforts towards identifying and responding to risk in the territories and jurisdictions where they operate. Ensuring better quality, consistency and transparency in ESG reporting can help enhance the value and sustainability of investments, especially in areas crucial for the planet and its future."

"Embedding mandatory human rights due diligence (mHRDD) in business operations could complement ESG and responsible investment provisions. It can play an important role in supporting developing countries' efforts to attract responsible investment and reducing human rights risks in value chains."

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risques financiers associés aux facteurs environnementaux, sociaux et de gouvernance, le reporting ESG se concentre sur l'évaluation de l'exposition des entreprises aux risques liées à ces mêmes facteurs. Le rapport souligne les limites des cadres ESG en matière d'identification et de prévention des risques d'incidences négatives sur les droits de l'homme, et met l'accent sur la nécessité de mesures complémentaires telles que la mise en place de procédure de vérification préalable obligatoire. Enfin, il met en avant la nécessité d'une plus grande cohérence dans les cadres ESG, à même de favoriser l'investissement responsable, de promouvoir les droits de l'homme et de faire progresser les objectifs de développement durable.

MOTS-CLÉS: *les critères environnementaux, sociaux et de gouvernance (ESG), les stratégies d'investissement, les rapports d'entreprise, les droits de l'homme, l'investissement responsable, la responsabilité des entreprises, la durabilité*

La creciente integración de los principios ambientales, sociales y de gobernanza (ASG) en los marcos de inversión y los informes corporativos refleja un mayor reconocimiento de la interacción entre las operaciones empresariales y los derechos humanos. Este Informe sobre Políticas examina la evolución de la inversión ASG, en particular su papel en la promoción de la inversión responsable y la incorporación de consideraciones de derechos humanos en las prácticas empresariales y las cadenas de suministro. Aunque los marcos ASG son prometedores para mejorar la responsabilidad y la sostenibilidad corporativas, persisten los desafíos para vincular eficazmente los criterios ASG con las normas de derechos humanos. También muestra que las disparidades en los criterios y metodologías de información ASG, agravadas por una falta de entendimiento común, plantean obstáculos a un compromiso significativo con las responsabilidades en materia de derechos humanos. El Informe también distingue entre la inversión ASG y la información ASG, destacando los distintos objetivos y prácticas. Mientras que la inversión ASG tiene como objetivo mitigar los riesgos financieros asociados a factores medioambientales, sociales y de gobernanza, la información ASG se centra en evaluar la exposición de las empresas a los riesgos ASG. Este Informe sobre Políticas subraya las limitaciones de los marcos ASG a la hora de identificar y prevenir de forma exhaustiva los impactos sobre los derechos humanos, enfatizando la necesidad de medidas complementarias como la diligencia debida obligatoria en materia de derechos humanos. Por último, el documento considera la necesidad de una mayor coherencia y consistencia en los marcos ASG para fomentar la inversión responsable, promover los derechos humanos y avanzar en los objetivos de desarrollo sostenible.

PALABRAS CLAVES: *los principios ambientales, sociales y de gobernanza (ASG), los marcos de inversión, los informes corporativos, los derechos humanos, la inversión responsable, la responsabilidad corporativa, la sostenibilidad corporativa*

1. Introduction

The adoption of Environmental, Social and Governance (ESG) based investment frameworks and ESG reporting by corporations has increased in the recent years, in part due to the increased awareness of the links between business and human rights. The use of ESG could contribute to the promotion of responsible investment and incorporate the respect for human rights in business operations, including throughout their supply chains while providing material benefits to the enterprise at the same time.

There is increased awareness on how investments can impact human rights[1], leading to greater uptake of National Actions Plans on Business and Human Rights at the country level[2] for implementation of the United Nations Guiding Principles on Business and Human Rights (UNGPs). At the same time, investors and consumers are increasingly demanding that businesses operate ethically and responsibly, which includes respecting human rights in all their operations, including throughout their value chains.

However, there are several concerns when it comes to using ESG for promoting business respect for human rights. For instance, the United Nations (UN) Working Group on Business and Human Rights has highlighted that "a key challenge is that most financial actors fail to connect human rights standards and processes with ESG criteria and investment practices because of a prevailing lack of understanding in the sector that social criteria, and many environmental and governance indicators, reflect human rights issues. This is further compounded by the lack of common standards and even understanding of what constitutes ESG practices"[3]. The Working Group has also noted that "despite the trend toward increased ESG investing, human rights are still rarely addressed in a systematic or principled way. The vast majority of institutional investors have yet to meaningfully engage with their human rights responsibilities. Human rights are often seen as a narrow set of issues limited to the 'S' of ESG rather than understood as relevant across a wide range of ESG-related issues"[4].

There has been an increase in ESG reporting[5] by large transnational corporations and some other business enterprises in recent years. ESG is also finding more space in the decision-making of investors, such as large private venture funds, asset managers and sovereign wealth funds. ESG may be present in the form of standalone policies or as part of larger 'sustainability'[6] or responsible sourcing initiatives.

1 See: South Centre, "Virtual Consultation in Support of the UN Working Group's 2021 Report to the UN General Assembly on Human Rights-Compatible International Investment Agreements", 23 June 2021. Available from https://www.southcentre.int/wp-content/uploads/2021/08/HRs-compatible-IIAs-report.pdf.
2 See: Debevoise & Plimpton, "UN Guiding Principles on Business and Human Rights at 10: The Impact of the UNGPs on Courts and Judicial Mechanisms". Available from https://www.ohchr.org/sites/default/files/Documents/Issues/Business/UNGPsBHRnext10/debevoise.pdf.
3 Guiding Principles on Business and Human Rights at 10: taking stock of the first decade, Report of the Working Group on the issue of human rights and transnational corporations and other business enterprises, A/HRC/47/39, 22 April 2021, paras. 79-80.
4 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. Available from https://www.ohchr.org/sites/default/files/Documents/Issues/Business/UNGPs10/Stocktaking-investor-implementation.pdf.
5 Matthew Mazzoni and Jennifer Teefey, "ESG + Incentives 2023 Report", Harvard Law School Forum on Corporate Governance, 3 September 2023. Available from https://corpgov.law.harvard.edu/2023/09/03/esg-incentives-2023-report/.
6 The lack of a clear definition of ESG or 'sustainability' has led to both terms being used interchangeably and inconsistently by business enterprises and other stakeholders, which poses another challenge.

However, the existence of different reporting criteria used by ESG rating firms, responding to their own algorithms, metrics and definitions results in there being no common understanding of what is covered under ESG. Further, such reporting criteria frequently seek to identify the risks that companies and investors might face from ESG issues, rather than assessing the risk and impacts of the company's operations on the environment, or society.

Several jurisdictions have adopted non-financial reporting standards that require companies to publicize how they respond to ESG issues. These efforts come at a time where ensuring business respect for human rights is being included by countries in their National Action Plans as an essential element for responsible business conduct[7]. Building greater coherence and consistency in the use of ESG frameworks can help channel more responsible foreign investment to the host States and ensure greater respect for human rights, more responsible business conduct and beneficial outcomes for all stakeholders.

2. Differentiating between ESG Investing and ESG Reporting

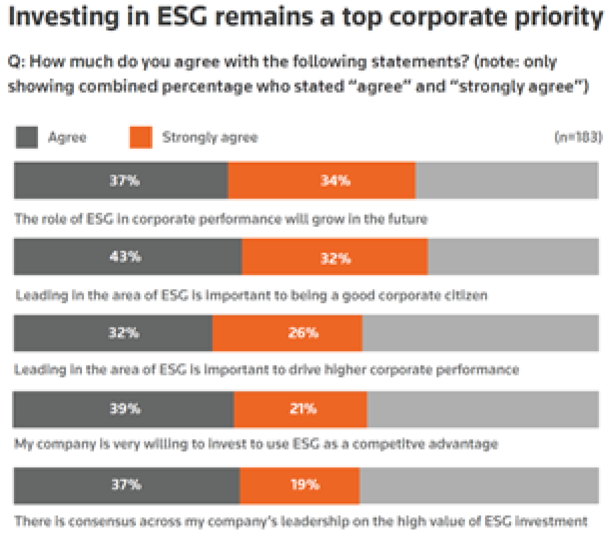
Generally, ESG has been characterised as "a risk management and investment framework that seeks to evaluate the financial risks that environmental, social, and governance factors pose for a company's value"[8]. Thus the primary rationale for developing ESG has been the de-risking of investment portfolios and increasing the economic resilience of a company.

While there are still many steps that corporations need to take in order to align their business practices to the various elements under ESG frameworks, many have started to consider ESG as a top corporate priority (see Figure 1).

However, the different concepts/practices covered under the spectrum of ESG, such as ESG-related investing and reporting, have followed their own trajectories. Thus, there is a need to differentiate ESG investing from ESG reporting, as the policies applicable to them, as well as the objectives they pursue differ considerably. Both concepts are explored in greater detail below.

7 See: Peru's National Action Plan on Business and Human Rights (NAP) 2021-2025. Available from https://www.gob.pe/institucion/minjus/informes-publicaciones/1959312-plan-nacional-de-accion-sobre-empresas-y-derechos-humanos-2021-2025.
8 Julia Binder," Let's be clear: ESG is not 'woke' and it's different from sustainability", I by IMD Magazine, 3 February 2023. Available from https://www.imd.org/ibyimd/magazine/lets-be-clear-esg-is-not-woke-and-its-different-from-sustainability/.

Figure 1



Source: Thomson Reuters Institute, The 2023 State of Corporate ESG, p. 7.

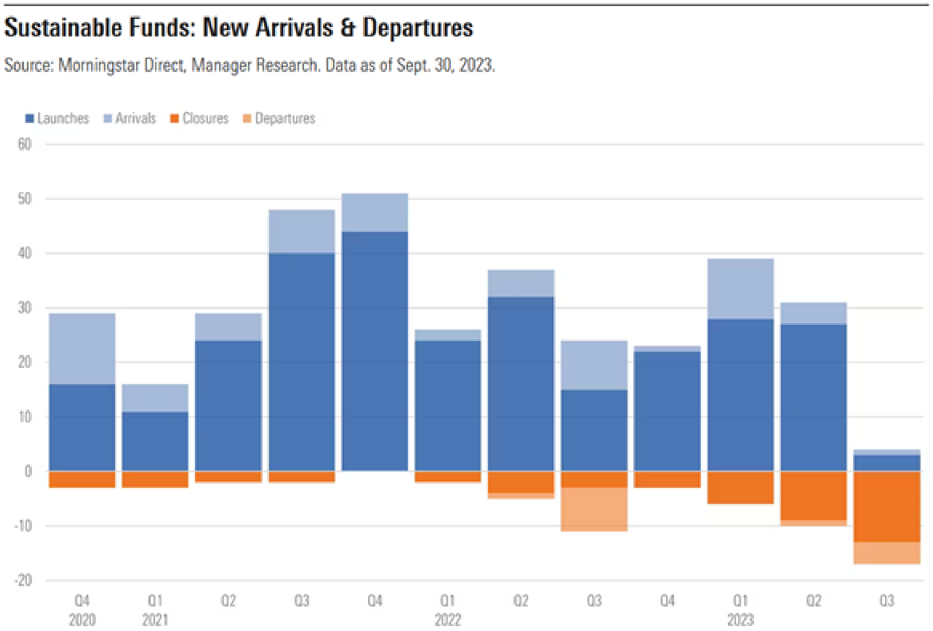
2.1. ESG Investing

ESG investing generally considers the set of standards and principles applicable to a company or investment, which are used by investors to screen the potential impact of their activities and identify possible risks. Thus, investors can choose to invest in those companies that actively promote ESG values and principles in their activities. To ensure that their investments are responsible, some investors actively consider the ESG characteristics of funds and corporations' portfolios, alongside their financial attributes, when evaluating potential investment opportunities. Such use of ESG in making investment decisions has been portrayed as a business response to consider the interests of various stakeholders, including employees, communities, and society at large[9].

For investors, using ESG factors has the potential to reduce risks, enhance reputations and even gain better equity returns, especially in publicly listed funds and traded companies. For instance, it has been reported that the number of exchange-traded funds carrying an ESG label more than doubled since the onset of the COVID-19 pandemic, reaching almost 1,300 at the end of 2022[10]. Nonetheless, the implementation of these ESG funds have different approaches, encompassing their carbon footprint, labor standards, diversity and inclusion policies and executives' compensation, among others. This multiplicity of approaches has led to criticisms on the arbitrary use of ESG indicators to reflect their contributions towards environmental and social objectives. This has also been reflected

9 E Napoletano, "Environmental, Social and Governance: What is ESG Investing?", Forbes (2023). Available from https://www.forbes.com/advisor/investing/esg-investing/.
10 Chris Flood, "Investors warned of 'greenwashing' risk as ESG-labelled funds double", *Financial Times*, 24 April 2023. Available from https://www.ft.com/content/79772342-d260-4dd5-b943-5e75bc27878c.

Figure 2



Source: Morningstar Direct[11]

in the more recent slowdown in 'sustainable funds' (see Figure 2).

It is also important to highlight the kind of investors who are investing in ESG funds. For instance, one survey found that four in five not-for-profit investors see ESG as important[12]. Similarly, many large institutional investors including asset managers, pensions funds and even sovereign wealth funds have been including ESG criteria in their investments[13]. The assets controlled by ESG funds have also been increasing in recent years (see Figure 3 in next page), with estimates suggesting it will hit $53 trillion by 2025[14].

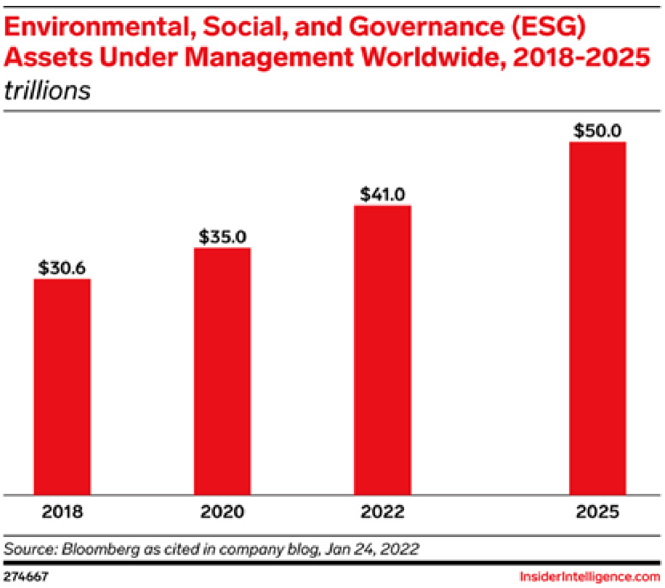
While some investors pursue investments only if they lead to better ESG-related outcomes, others understand it in terms of a company's exposure to financially material environmental, societal and governance risks. Therefore, ESG indices also play an important role in directing ESG investing, as they benchmark and include companies that meet certain ESG criteria and exclude or underweight companies that are unable to do so.

The inclusion of a company in such indices can be materially relevant to the investment and financing they can raise. Although ESG can serve as a tool for reducing investors' risk from investments in companies operating in sensitive locations or sectors, or those with a track record of dubious or unethical conduct, the differing criteria used by such indices as well as the lack of common understanding creates a lacunae for both investors and the firms, as well as the countries that serve as investment destinations. Research has also found that "while ESG indices could potentially have a sustainability impact, most currently do not meaningfully facilitate sustainability"[15].

The United Nations Conference on Trade and Development (UNCTAD) Secretary-General Rebeca Grynspan has considered that "ESG investment is still a largely unfulfilled promise as most of it flows among wealthier nations and remains in the world's largest public companies (...) more efforts should be directed to fighting ESG greenwashing, as well as leveraging ESG and sustainability-themed trends to create new financial products, which can channel investment from developed to developing countries, and from the private sector to development projects"[16]. Thus, it is necessary to take further steps for aligning the criteria used for ESG investing, and channelling it better towards the Sustainable Development Goals (SDGs).

11 Alyssa Stankiewicz, "Sustainable Funds Hit by Weaker Demand in Q3 2023", Morningstar Direct, 23 October 2023. Available from https://www.morningstar.com/sustainable-investing/sustainable-funds-hit-by-weaker-demand-amid-rising-energy-prices-political-backlash.
12 Joe Lepper, "Four in five not-for-profit investors see ESG as important, survey finds", *Charity Times*, 15 November 23. Available from https://www.charitytimes.com/ct/Four-in-five-charity-investors-see-ESG-as-important-to-their-investment-strategy.php.
13 United Nations Conference on Trade and Development, *Sustainability integration by public pension and sovereign wealth funds, 2022*. Available from https://unctad.org/publication/sustainability-integration-public-pension-and-sovereign-wealth-funds-2022.
14 "ESG assets may hit $53 trillion by 2025, a third of global AUM", Bloomberg Intelligence, 23 February 2021. Available from https://www.bloomberg.com/professional/blog/esg-assets-may-hit-53-trillion-by-2025-a-third-of-global-aum/.
15 J. Fichtner, R. Jaspert and J. Petry, "Mind the ESG capital allocation gap: The role of index providers, standard-setting, and 'green' indices for the creation of sustainability impact". Regulation & Governance (2023). Available from https://doi.org/10.1111/rego.12530.
16 "More investment needed to get global goals back on track, says UNCTAD chief", UNCTAD, 19 January 2023. Available from https://unctad.org/news/more-investment-needed-get-global-goals-back-track-says-unctad-chief-0.

Figure 3



Source: Insider Intelligence[17]

2.2. ESG Reporting

In contrast to ESG investing, ESG reporting is largely based on the set of criteria and metrics used by companies for evaluating their *vulnerability* to ESG risks[19]. Such reporting allows investors to assess a firm's risk exposure to ESG issues and understand how those might affect its possible future performance. The factors that are included in ESG reporting are highly variable, and their importance may also differ based on the kind of investor considering them (see Figure 4).

In many cases, reporting is based on the work done by ESG rating companies that have evolved their own criteria on what qualifies as relevant ESG risks in which sector (in rare instances, a usually large firm may develop and use its own ESG framework for reporting). Some reporting criteria developed by ESG rating agencies might also allow for comparison with the company's competitors[20]. These methodologies can help firms to gain leverage in ESG markets, better position themselves as being environmentally or socially 'conscious' and benefit from special funds targeted towards attaining social or environmental objectives. For example, research suggests that there is a strong demand for ESG investments, with so-called "'sustainable' funds globally attracting net inflows of $49 billion in the first half of [2023] … , while the rest of the fund industry saw outflows of $9 billion"[21]. In rare instances, investors have even pulled out their investment from companies that failed to meet or had insufficient ESG targets[22].

Figure 4 - Survey results on most important elements of ESG reporting

Source: ESG Global Study 2022[18]

17 Will Paige, "Predictions for ESG in 2023: Stronger regulations and intensifying competition will fail to end sustainable investing boom", Insider Intelligence, 21 December 2022. Available from https://www.insiderintelligence.com/content/2023-predictions-esg-sustainable-finance.
18 Jessica Ground, "ESG Global Study 2022", Harvard Law School Forum on Corporate Governance, 17 June 2022. Available from https://corpgov.law.harvard.edu/2022/06/17/esg-global-study-2022/.
19 Jan Rydzak, "ESG Data Needs a Human Rights Upgrade", Ranking Digital Rights. Available from https://rankingdigitalrights.org/mini-report/esg-data-needs-a-human-rights-upgrade/.
20 See: MSCI, "What is an MSCI ESG Rating?". Available from https://www.msci.com/our-solutions/esg-investing/esg-ratings.
21 Steve Johnson, "Companies with good ESG scores pollute as much as low-rated rivals", *Financial Times*, 31 July 2023. Available from https://www.ft.com/content/b9582d62-cc6f-4b76-b0f9-5b37cf15dce4.
22 Leslie Hook and Brooke Masters, "BlackRock breaks with Glencore over environment policy", *Financial Times*, 10 September 2023. Available from https://www.ft.com/content/5b0d426a-87fe-4998-a3d6-3cf9f5669e6a.

Efforts towards increasing private sector support and investments to achieve the UN 2030 Agenda for Sustainable Development and the SDGs[23] have featured prominently in the current discourse on sustainable responsible ESG investment[24]. For instance, the UN Secretary-General Antonio Guterres has called on investors "to catalyze greater investment for developing countries and make net zero and sustainability the core of everyone's policies and business models."[25] Some firms have committed to prioritising the use of the SDGs in their ESG reporting as a survey found that "almost a third of investors think this is one of the most important elements of fund sustainability reporting"[26] and can be used as a framework for comparison of the reporting outcomes of businesses.

ESG reporting has also come to the attention of some regulatory authorities, given that some firms are advertising their pro-ESG credentials without providing sufficient evidence of the same[27]. For example, the European Union (EU) is now considering a ban on sweeping environmental claims such as the use of "climate neutral" or "eco" labels unless companies can prove that the claim is accurate[28]. The United States Securities and Exchange Commission has also sought to take action against ESG-related misconduct and "greenwashing" by firms, bringing enforcement actions and levying fines[29].

In addition, there are concerns on how measuring the achievement of ESG targets is turning into a 'box-ticking' exercise, without sufficient or independent verification of the claims being made by the businesses[30]. This effectively results in undermining the value of ESG disclosures, while maintaining a semblance of transparency for investors and customers. There are some initiatives being taken to ensure greater regulation of ESG rating and reporting, which are explored in the following section.

23 "Sustainable Development Goals 'Will Fail without Private Sector Support', Deputy Secretary-General Tells High-Level Dialogue on Partnerships", United Nations Press Release, DSG/SM/1839, 14 March 2023. Available from https://press.un.org/en/2023/dsgsm1839.doc.htm.
24 Nisha Narayanan, "How ESG investing can better serve sustainable development", Atlantic Council, 21 June 2023. Available from https://www.atlanticcouncil.org/blogs/econographics/how-esg-investing-can-better-serve-sustainable-development/.
25 "Business leaders join UN chief to step up action for sustainability", UN News, 19 October 2021. Available from https://news.un.org/en/story/2021/10/1103412.
26 Jessica Ground, "ESG Global Study 2022", Harvard Law School Forum on Corporate Governance, 17 June 2022. Available from https://corpgov.law.harvard.edu/2022/06/17/esg-global-study-2022/.
27 "UK watchdog says some funds attempting to mislead with ESG label", *Reuters*, 19 October 2023. Available from https://www.reuters.com/sustainability/sustainable-finance-reporting/uk-watchdog-says-some-funds-attempting-mislead-with-esg-label-2023-10-19/.
28 Alice Hancock, "EU to ban 'climate neutral' claims by 2026", *Financial Times*, 20 September 2023. Available from https://www.ft.com/content/53f84f03-1f1c-4240-977f-9de0e4893377.
29 Douglas Gillison and Michelle Price, "US SEC cracks down on funds "greenwashing" with new investment requirement", *Reuters*, 20 September 2023. Available from https://www.reuters.com/sustainability/us-sec-poised-ban-deceptive-esg-growth-fund-labels-2023-09-20/.
30 David Breg, "More Companies Are Disclosing Their ESG Data, but Confusion on How Persists", *WSJ*, 21 September 2023. Available from https://www.wsj.com/articles/more-companies-are-disclosing-their-esg-data-but-confusion-on-how-persists-e667698c.

3. Public and private practices on ESG

While some countries have established frameworks that require investors and corporations to respect human rights as part of their business operations and have mandatory human rights due diligence requirements[31], the vast majority of these are still voluntary and non-binding in nature. Many such frameworks are also in the form of corporate social responsibility (CSR) requirements, which can intersect and complement ESG reporting, while still falling short of the threshold for protection and promotion of human rights, including for providing access to remedies to victims of human rights violations.

At the international level, the vast majority of initiatives are voluntary in nature and in the form of guidelines or principles which can be adopted by the business community. For instance, the UN Global Compact is a non-binding set of ten principles to be incorporated by companies to "align their strategies and operations (...) with human rights, labour, environment and anti-corruption, and take actions that advance societal goals and the implementation of the SDGs"[32].

The Principles for Responsible Investment (PRI) were developed by the investment community and launched in 2006 to provide "a voluntary framework by which all investors can incorporate ESG issues into their decision-making and ownership practices"[33]. The PRI consider responsible investment as "a strategy and practice to incorporate environmental, social and governance factors in investment decisions and active ownership"[34]. It further elaborates on ESG factors as including climate change, resource depletion, pollution, human rights, modern slavery, bribery and corruption, among others. Similarly, the Equator Principles have been developed by a coalition of banking and other financial institutions for incorporating environmental and social risks into project finance transactions, and to "serve as a common baseline and risk management framework for financial institutions to identify, assess and manage environmental and social risks when financing projects"[35].

There have been recent developments at the European Union[36] with regard to a new proposal for regulating the transparency and integrity of ESG rating activities. The proposal highlights that "the current ESG rating market suffers from deficiencies and is not functioning properly,

31 See for instance, France's LOI n° 2017-399 *relative au devoir de vigilance des sociétés mères et des entreprises donneuses d'ordre*.
32 Lise Kingo, "The UN Global Compact: Finding Solutions to Global Challenges", UN Chronicle. Available from https://www.un.org/en/un-chronicle/un-global-compact-finding-solutions-global-challenges.
33 UN Global Compact. Available from https://unglobalcompact.org/take-action/action/responsible-investment.
34 Principles for Responsible Investment. Available from https://www.unpri.org/download?ac=10948.
35 Equator Principles. Available from https://equator-principles.com/about-the-equator-principles/.
36 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, 2023/0177 (COD), 13 June 2023.

with investors and rated entities' needs regarding ESG ratings are not being met and confidence in ratings is being undermined. This problem has a number of different facets, mainly (i) the lack of transparency on the characteristics of ESG ratings, their methodologies and their data sources and (ii) the lack of clarity on how ESG rating providers operate. ESG ratings do not sufficiently enable users, investors and rated entities to take informed decisions as regards ESG-related risks, impacts and opportunities."[37] Thus, the proposal does not seek to harmonize the methodologies for the calculation of ESG ratings, but merely to increase their transparency.

However, this proposal also comes in the backdrop of the new EU Corporate Sustainability Reporting Directive (CSRD) and the European Sustainability Reporting Standards (ESRS) which came into force in 2023. The CSRD outlines the rules concerning the social and environmental information that companies have to report, which will help investors and other stakeholders to "assess the impact of companies on people and the environment and for investors to assess financial risks and opportunities arising from climate change and other sustainability issues"[38]. In addition, the EU is also discussing a new Corporate Sustainability Due Diligence Directive[39], which "aims to establish a corporate duty to respect human rights and the environment by requiring certain companies to identify and address harms arising from their operations and those of their subsidiaries across their value chain"[40].

The United Kingdom[41] has been undertaking consultations to create regulations for ESG rating firms. It has also developed a draft voluntary code of conduct for ESG data and ratings providers[42]. The USA is having several divergent approaches at its state level with regard to ESG-related policies. One report has highlighted that, "Twenty-two states have adopted anti-ESG related laws; and while some states have incorporated ESG into their investment strategies, but many others forbid fiduciaries from using ESG considerations in investing state funds"[43]. Further, it notes that "some states have enacted broader laws prohibiting boycotts of industries perceived to be out of favor in regards to ESG principles. Meanwhile, other states, notably California, are passing laws informed by ESG considerations."[44]

Several developing countries have been taking initiatives to include ESG reporting for listed and public traded companies operating within their territories, which are largely in the form of requiring reporting of non-financial data. Some regulatory bodies for stock exchanges have taken the lead in this effort.

The Brazilian Securities and Exchange Commission (CVM) has introduced regulations related to ESG reporting for publicly traded companies. The ESG information disclosure criteria spelled out in its Resolution No. 59 (RCVM 59)[45] includes the requirement for the business to indicate "whether the report or document considers UN Sustainable Development Goals (SDGs) and what are the material SDGs for the issuer's business"[46]. It also touches upon climate issues, asking whether the business carries out greenhouse gas emission inventories, and indicating the scope of any such inventoried emissions.

India's Securities and Exchange Board (SEBI) has introduced regulations that require the top 1,000 listed companies to disclose their business responsibility reports, which include information on ESG aspects. This 'Business Responsibility and Sustainability Report' (BRSR) covers several important attributes of the business enterprise such as its greenhouse gas footprint, total water and energy consumption, waste management, employee well-being and safety, gender diversity among others[47].

The Securities Commission of Malaysia has recently revised its Guidelines on Sustainable and Responsible Investment Funds[48] which set out the reporting and disclosure requirements for a fund to qualify as a Sustainable and Responsible Investment Fund[49]. It has

37 Ibid., p. 1.
38 European Commission, Corporate sustainability reporting. Available from https://finance.ec.europa.eu/capital-markets-union-and-financial-markets/company-reporting-and-auditing/company-reporting/corporate-sustainability-reporting_en.
39 European Commission, Corporate sustainability due diligence. Available from https://commission.europa.eu/business-economy-euro/doing-business-eu/corporate-sustainability-due-diligence_en.
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also come out with a Principles-Based Sustainable and Responsible Investment Taxonomy for the Malaysian Capital Market, which "aims to give clarity towards enabling proper and consistent identification and classification of various types of economic activities as well as the definition of sustainable investments. It also seeks to address concerns on the need to mitigate and manage the risks of greenwashing"[50].

Similarly, the Financial Superintendence of Colombia has "issued requirements for integrating ESG and climate risks in the investment policy and governance arrangements of pension funds and insurance companies. It has also increased disclosure requirements for funds with ESG, sustainability and/or green claims, set ESG and climate risk reporting requirements for listed companies and published supervisory expectations on climate risk management for banks"[51]. Similarly, the Colombian Green Taxonomy, launched on 11 April 2022, is a "classification of environmentally sustainable economic activities and assets that will serve as guideline for green financing and will help align the private sector with the national objectives and international environmental commitments"[52].

In Chile, the Chilean Commission for the Financial Market (*Comisión para el Mercado Financiero*, CMF) issued General Rule No. 461, which includes the ESG related information that must be disclosed in the end-of-year reports of the supervised entities. It requires them to disclose strategic commitments adopted in furtherance of the SDGs or other similar initiatives[53].

There has also been an uptick in the adoption of ESG reporting requirements in financial markets across the African continent[54]. For example, the Johannesburg Stock Exchange has developed a Sustainability Disclosure Guidance and a Climate Change Disclosure Guidance, which are "aligned with, and draw on the most influential global initiatives on sustainability and climate change disclosure"[55].

4. ESG investing and developing countries' priorities

ESG factors are broadly related to responsible investment, but they may not have a direct impact on the sustainable development or achievement of social goals in developing countries. Although ESG assets have increased in last years, amounting to almost US$53 trillion, the SDG financing gap is expanding rather than contracting.[56] At the same time, almost a third of the funds registered under Article 8 of the European Union's Sustainable Finance Disclosure Regulation, which intends to promote environmental and social financial products are targeting non-sustainable investments[57], which possess "an element of greenwashing until clear definitions and metrics are put in place."[58]

Given that ESG monitoring allows for the identification of financial risks and opportunities for investment, large firms have increased their spending, making operational changes towards making them 'net zero'. Nevertheless, the majority of these assets under management (AuM) are located in the developed world, in particular the United States and Europe (see Figure 5 in next page).

While the COVID-19 pandemic resulted in a global economic slowdown, regional tensions in Europe have boosted investments in renewable energy towards guaranteeing energy security. The majority of global ESG advisory market reflects the concerns of developed countries, considering for example that more than 50% of total demand of ESG and sustainable consulting services is from the United States and that the majority of concerns are linked to environmental factors, leaving the 'social' factor at the margins (see Figure 6 in next page).

Given that the majority of ESG portfolios are aimed at developed markets, there are still doubts on how ESG factors will contribute to the most pressing social and environmental concerns of developing countries, in particular low-income economies. Thus, while ESG can play an important role in ensuring that corporations contribute to the promotion of sustainable development and human rights in the host States, strong efforts are still needed to align ESG concerns with the

Investment Funds", Eye on ESG, 21 March 2023. Available from https://www.eyeonesg.com/2023/03/securities-commission-malaysia-publishes-revised-guidelines-on-sustainable-and-responsible-investment-funds/.
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51 World Bank, "Colombia: Leading the Path to Sustainability in Latin America", 7 September 2022. Available from https://www.worldbank.org/en/news/feature/2022/08/31/colombia-leading-the-path-to-sustainability-in-latin-america.
52 Mariana Escobar Uribe, Presentation on ESG: Market development and disclosure standards in Colombia, 26 April 2022. Available from https://www.cmfchile.cl/portal/prensa/615/articles-50356_presentacion_mariana.pdf.
53 Juan Antonio Parodi, Raúl Álvarez and Verónica Cuadra, "Law Over Borders Comparative Guide: Environmental, Social & Governance in Chile", *The Global Legal Post*, September 2023. Available from https://www.globallegalpost.com/lawoverborders/environmental-social-governance-559211028/chile-90451183.
54 Rachel Savage, "More African countries implementing ESG finance policies – study", *Reuters*, 13 October 2022. Available from https://www.reuters.com/business/finance/more-african-countries-implementing-esg-finance-policies-study-2022-10-13/.
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56 Marcos Athios Neto, "Why ESG is failing sustainable development", Sustainable Finance Hub.
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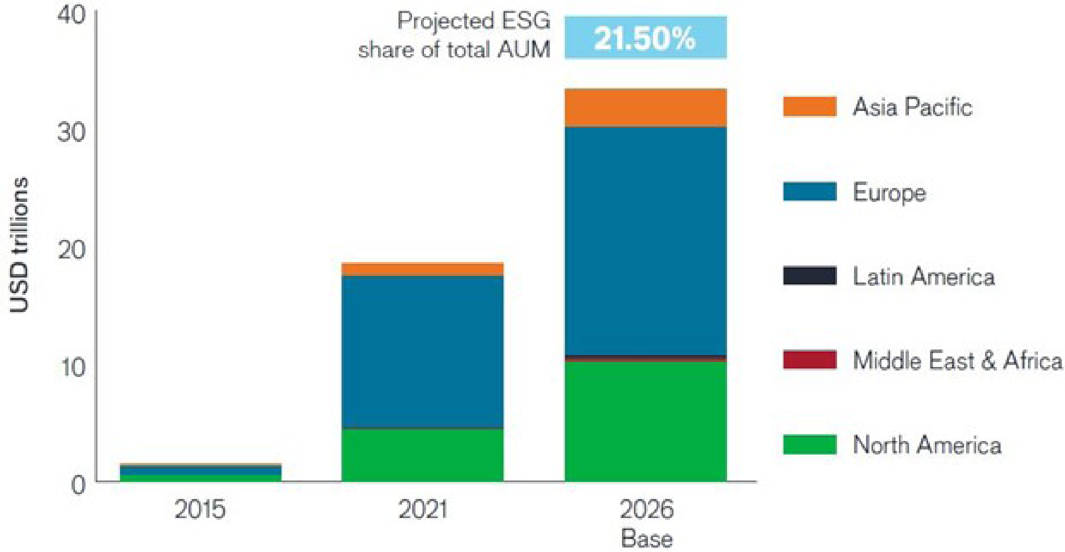
58 Ibid.

Figure 5 - Projected global ESG AuM growth (2021 – 2026)



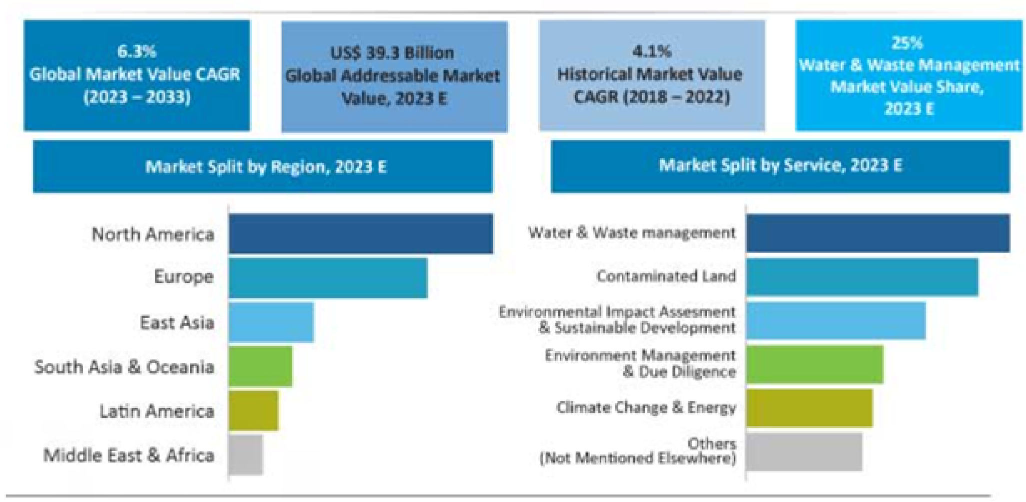
Source: PricewaterhouseCoopers[59]

national development priorities of countries.

5. Challenges and weaknesses of ESG

While the efforts mentioned above could help increase transparency and uniformity in ESG disclosures by businesses, ESG reporting currently faces several challenges and weaknesses. The public disclosure requirements as part of non-financial reporting is limited to publicly listed companies, which limits their effectiveness in promoting a single standard for all businesses to follow. Similarly, the ESG designation is normally self-attributed by firms disclosing their reports, or by private firms specialised in providing ESG ratings. Currently, there are no specialized metrics on measuring companies' impacts on social aspects, including on human rights. The diversity of populations and unique societal contexts relevant to businesses also raise concerns when focusing on a single 'social' metric. Therefore, ESG alone is an insufficient tool to understand, measure or mitigate the human rights and other impacts of business activities,

Figure 6 - Global ESG & Sustainability Advisory Market Forecast, 2023 – 2033



Source: Fact.MR

59 PricewaterhouseCoopers, *Asset and wealth management revolution 2022: Exponential expectations for ESG* (October 2022). Available from https://www.pwc.com/gx/en/financial-services/assets/pdf/pwc-awm-revolution-2022.pdf.

especially regarding the impacts on the most vulnerable peoples and communities in developing countries.

Similarly, the use of multiple methodologies and the lack of a universal 'taxonomy' on ESG, raise concerns about the divergences in the interpretation of ESG disclosures by private firms[60]. These divergences and the lack of clear standards allow companies to indulge in 'green-, blue- or pink-washing'[61], which can mislead the public and their stakeholders into believing that the business is doing something to protect the environment, respond to climate change challenges or respect human rights[62]. For example, some corporations have made claims about becoming 'carbon-neutral' despite having no credible evidence for the same[63]. This has already triggered lawsuits against such firms for false and misleading advertising[64]. Likewise, even in cases where 'clearer' criteria exist, such as for measuring the carbon footprint of companies, rating firms can decide to not consider greenhouse emissions of a company to allow their ESG rating to be upgraded[65]. Thus, trust in ESG ratings has remained low among advisers and wealth managers, with a majority considering that "ESG ratings lack credibility because different providers can give the same fund very different scores"[66].

Given that ESG ratings are commercial products of private rating firms, these scores can be freely adjusted to be showcased to investors and customers and respond to their needs[67], rather than requiring companies to change their behaviour and integrate responsible business practices in their operations and corporate culture. Particular attention also needs to be given to the possible conflicts of interest of ESG rating agencies, including monetary conflicts, due to the sale of consulting services to the very companies rated by them[68] or included in ESG indices that the rating firms themselves operate.

In addition, research has shown that current methodologies used for 'social' scoring by rating agencies include limited or no indicators on human rights[69]. The fact that existing human rights principles and standards applicable to businesses' operations are not directly included in ESG ratings marginalizes the importance of human rights in the social aspect of ESG, and ignores the basic responsibility of corporations to respect human rights, including their duty to establish due diligence processes to identify, prevent, mitigate and account for human rights violations and impacts in their business activities.

The recommendations of the former UN Independent Expert on Foreign Debt and Human Rights, Mrs. Yuefen Li, in her report on credit rating agencies[70] are applicable, *mutatis mutandis*, to the ESG rating companies. In particular, efforts must be made to address conflicts of interest; introduce systems of monitoring and accountability of rating companies; strengthen the incorporation and application of relevant international human rights standards and norms in their activities; and to enhance disclosure and transparency of the rating methodology. Yet, while credit rating agencies are nominally regulated, there is no such regulation of ESG rating firms[71].

It has been considered that "ESG as a framework does not sufficiently capture harms to people (and resulting risk to business) or guide decisions that take human rights into account. ESG can easily fail to identify and address notable human rights harms"[72]. In the same way, the objectives and nature of ESG reporting demonstrate that it alone is insufficient to identify, mitigate and account for the human rights impacts of business activities. Even if ESG reporting were to be extended to all businesses and not limited to large corporations, there will be a need to take into account the proportionality of the impacts and relevant capacities of small and medium sized enterprises in developing countries, which may not have the necessary resources or expertise available to fulfil such reporting requirements.

6. Conclusions

While ESG ratings can be a tool to support business' efforts towards identifying and responding to risk in the territories and jurisdictions where they operate. Ensuring better quality, consistency and transparency in ESG reporting can help enhance the value and sustainability of investments, especially in areas that are crucial for the planet and its future. Multilateral, regional and other intergovernmental organizations should support developing countries in establishing their own legal and policy frameworks to regulate business enterprises and ensure that they respect human rights in all their operations and throughout their supply chains.

ESG is likely to play an important role in determining which sectors, firms and jurisdictions will be able to attract foreign investment, as investors seek to be more responsible and sustainable in their activities. The selection of relevant ESG factors and which firms make it on to ESG indices will be equally important for the green transition and adapting to climate change as firms and developing countries look for sources of financing that can help them deal with the fiscal impacts of adaptation as well as loss and damage due to climate change.

60 Michela Scatigna, Dora Xia and others, "Achievements and challenges in ESG Markets", *BIS Quarterly Review*, December 2021, p. 94. Available from https://www.bis.org/publ/qtrpdf/r_qt2112f.pdf.
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63 Gemma Bowcock, "Hollow corporate promises: How to stop false climate claims", Carbon Market Watch, 28 February 2022. Available from https://carbonmarketwatch.org/2022/02/28/hollow-corporate-promises-how-to-stop-false-climate-claims/.
64 Patrick Greenfield, "Delta Air Lines faces lawsuit over $1bn carbon neutrality claim", The Guardian, 30 May 2023. Available from https://www.theguardian.com/environment/2023/may/30/delta-air-lines-lawsuit-carbon-neutrality-aoe.
65 Cam Simpson, Akshar Rathi and Saijel Kishan, "The ESG Mirage", Bloomberg, 10 December 2021. Available from https://www.bloomberg.com/graphics/2021-what-is-esg-investing-msci-ratings-focus-on-corporate-bottom-line/.
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67 See: Rydzak, *supra*.
68 David F. Larcker, Lukasz Pomorski, Brian Tayan, and Edward Watts, "ESG Ratings: A Compass without Direction" (August 2, 2022), Rock Center for Corporate Governance at Stanford University Working Paper (forthcoming). Available from https://ssrn.com/abstract=4179647.
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70 Debt relief, debt crisis prevention and human rights: the role of credit rating agencies, Report of the Independent Expert on the effects of foreign debt and other related international financial obligations of States on the full enjoyment of all human rights, particularly economic, social and cultural rights, Yuefen Li, A/HRC/46/29, 17 February 2021.
71 Kurt Wolfe, "Who Regulates the ESG Ratings Industry?", Bloomberg Law, 22 February 2022. Available from https://news.bloomberglaw.com/esg/who-regulates-the-esg-ratings-industry.
72 Paloma Muñoz Quick & Christen Dobson, "Bridging the Human Rights Gap in ESG", BSR blog, 22 March 2022. Available from https://www.bsr.org/en/blog/bridging-the-human-rights-gap-in-esg.

Similarly, incorporating responsible investment standards, such as the need to balance the rights and obligations of foreign investors and respect the right of States to regulate in their public interest, are essential for achieving the SDGs and the realization of human rights, and should be included in the international investment policies and agreements. Special attention should be paid to the recently adopted Protocol on Investment to the African Continental Free Trade Agreement (AfCFTA)[73] in this regard. Chapter 5 of the Protocol includes binding obligations for foreign investors, with innovative provisions such as on Business Ethics, Human Rights and Labour Standards which requires investors and their investments to comply with high standards of business ethics, investment-related human rights and labour standards; obligations to respect and protect the environment, in accordance with the human right to a clean, healthy and sustainable environment, among others.

Further, the Protocol also addresses the issue of corporate social responsibility, requiring investors to endeavour to achieve the highest possible level of contribution to the sustainable development of the Host State and the local community through the adoption of a high degree of socially responsible practices; as well as requiring investors to meet national, regional and internationally accepted standards of corporate governance, in particular in respect of transparency and accounting. This Protocol can therefore be a standard setter for investment agreements and a model for other countries seeking to strengthen ESG and human rights requirements for foreign investors.

At the same time, embedding mandatory human rights due diligence (mHRDD) in business operations could complement ESG and responsible investment provisions. It can play an important role in supporting developing countries' efforts to attract responsible investment and reducing human rights risks in value chains. States can encourage and require businesses, including foreign investors, to comply with their human rights responsibilities through various means, including standards set in National Action Plans, domestic legislation and international agreements.

The adoption of human rights due diligence requirements at national, regional and international levels can help prevent and mitigate the negative effects of business operations on human rights and provide access to effective remedy. Incorporating these practices in business operations can also allow for better monitoring and reporting of their effectiveness. The potential of mHRDD legislation to strengthen the prevention of human rights violations, while also addressing remediation after the occurrence of harm through State-based mechanisms, could be facilitated through the establishment of international standards on this matter.[74]

73 Danish, Hamed El-Kady, Makane Moïse Mbengue, Suzy H. Nikièma & Daniel Uribe, "The Protocol on Investment to the Agreement Establishing the African Continental Free Trade Area: What's in it and what's next for the Continent?", *Investment Treaty News*, 1 July 2023. Available from https://www.iisd.org/itn/en/2023/07/01/the-protocol-on-investment-to-the-agreement-establishing-the-african-continental-free-trade-area-whats-in-it-and-whats-next-for-the-continent/.

74 Daniel Uribe Terán, *Beyond Corporate Social Responsibility: Strengthening Human Rights Due Diligence through the Legally Binding Instrument on Business and Human Rights*, Research Paper, No. 138 (Geneva, South Centre, 2021). Available from https://www.southcentre.int/research-paper-138-october-2021/.

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