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Investors and the ESG blind spot

Upholding civic freedoms as part of geopolitical corporate responsibility

Harriet Moynihan

CHATHAM HOUSE

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Summary

- With responsible business, sustainable finance and environmental, social and governance (ESG) issues all gaining traction, institutional investors are now recognized alongside multinational corporations as 'geopolitical stakeholders'. But investor appreciation of the building blocks that underpin a resilient political and financial environment – the rule of law, accountable governance, civic space and civic freedoms – is still limited.
- Business and civil society both benefit from strong civic institutions (including an independent judiciary and media), the rule of law and the civic freedoms of expression, association and assembly. These elements of accountability are all critical to stable, profitable and sustainable business environments in which companies thrive and economies prosper.
- Civic space has been shrinking around the world in democratic and autocratic countries alike for some time. For investors and companies, which face growing public expectations that they should act responsibly, and which have increasing influence over global affairs, the reduction of civic space presents not only political but also legal, ethical, reputational and financial risks.
- Currently, there are several barriers to investor support for civic freedoms, including short-term decision-making; political sensitivities in relationships among investors, companies and host governments; the difficulty of measuring and integrating civic space issues into traditional investor methodology; and insufficient internal governance to support attention to these issues.
- Awareness among investors of the materiality of civic freedoms will take time to grow as forms of measurement and engagement are refined. In the meantime, positive trends include emerging scrutiny of civic space issues by some large institutional investors and companies; increasing regulation mandating corporate human rights due diligence; and a new generation that cares more about social values and is quick to mobilize in support online.
- For investors to demonstrate geopolitical corporate responsibility and match their rhetoric on social purpose with action, there needs to be a shift in both culture and process. By undertaking more comprehensive human rights due diligence and by increasing engagement with civil society stakeholders, investors and companies would be better able to identify and mitigate risks relating to civic space.

Introduction

Until the last decade, 'corporate social responsibility' was mostly a 'tick-box' exercise for investors, many of whom followed the doctrine of Milton Friedman that a company's social responsibility is to maximize profits and returns to its shareholders. But, there has been a gradual shift in attitude and practice amid rising societal expectations of business – whether on carbon emissions, worker safety or diversity.[1] Recent events such as the emergence of the Black Lives Matter movement, the COVID-19 pandemic and Russia's invasion of Ukraine have all forced business to recognize and grapple with the links between values, reputation and profitability.

Business and civil society operate in, and benefit from, a shared space defined by the rule of law and the civic freedoms of expression, association and assembly that are essential to the realization of all human rights, to good governance and accountable institutions.[2] A healthy 'civil society space' is one in which public decision-making is transparent, and in which non-governmental organizations (NGOs), human rights defenders, the judiciary and the media can operate independently to scrutinize government and corporate power. These elements of accountability are all critical to stable, profitable and sustainable business environments in which companies thrive and economies prosper. Progress on issues such as fair wages, equality and combatting corruption is intimately linked to full respect for the rule of law and civic freedoms, in which shareholders and all stakeholders should recognize a shared interest. Yet, the crucial relationship between investors and civic freedoms remains a relative blind spot.[3]

Investors therefore need to adopt a more comprehensive approach to environmental, social and governance (ESG) issues that recognizes the importance of the rule of law, strong civic institutions and civil society space to business. This wider focus is even more important and urgent at a time when civic freedoms are under threat around the world, and when investors are becoming increasingly influential as geopolitical stakeholders.

The ecosystem of global governance is expanding and rebalancing to reflect the inclusion of a much wider range of stakeholders, including business.[4] The last decade has seen an evolution towards 'stakeholder geopolitics',[5] with business both facing increasing expectations of action and exerting increasing influence. A 2022 survey conducted in 14 countries with 14,000 respondents found that 77 per cent of respondents saw improving societal issues as a primary business function, and 59 per cent regarded addressing geopolitics as a top priority for business.[6]

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1 Mayer, C., Strine Jr., L. and Winter, J. (2020), '50 years later, Milton Friedman's shareholder doctrine is dead', *Fortune*, 13 September 2020, https://fortune.com/2020/09/13/milton-friedman-anniversary-business-purpose.
2 Freeman, B. (2018), *Shared Space under Pressure: Business Support for Civic Freedoms and Human Rights Defenders*, Business & Human Rights Resource Centre and International Service for Human Rights, https://media.business-humanrights.org/media/documents/fdfe07e3d812cfcfed4235fbbf820a3d77599b13.pdf.
3 Nangle, T. (2023), 'A trillion-dollar blind spot for asset managers', *Financial Times*, 13 January 2023, https://www.ft.com/content/92e9ab44-a852-4c96-86e6-3b10f796e858.
4 Chatham House (2021), *Reflections on building more inclusive global governance: Ten insights into emerging practice*, Synthesis Paper, London: Royal Institute of International Affairs, https://www.chathamhouse.org/2021/04/reflections-building-more-inclusive-global-governance.
5 Brende, B. (2023), 'Why it's time for the dawn of stakeholder geopolitics', *Foreign Affairs*, 16 January 2023, https://www.foreignaffairs.com/world/dawn-stakeholder-geopolitics.
6 Edelman (2022), *2022 Edelman Trust Barometer Special Report: The Geopolitical Business*, report, May 2022, https://www.edelman.com/trust/2022-trust-barometer/special-report-geopolitical-business.

The Sustainable Development Goal (SDG) 16 Business Framework, launched by the UN Global Compact in 2021, encourages businesses to embrace 'transformational governance' by supporting peace, justice and strong institutions, strengthening multilateralism and 'reimagining the social contract'.[7] Investors have joined companies at the forefront of discussion and action on global issues, and have launched initiatives with the UN to tackle climate change (for example, through the Glasgow Financial Alliance for Net Zero).[8]

The last five years have seen a huge increase in investor engagement with ESG issues, with asset managers globally expected to increase ESG-related assets under management to $33.9 trillion by 2026, up from $18.4 trillion in 2021.[9] But investor approaches to these issues are in practice often siloed and fragmented. Even as the 'S' in ESG has gained traction and momentum, investors usually focus on a subset of niche social topics such as child labour, forced labour and modern slavery, as well as diversity, equity and inclusion, rather than situating these issues within a broader framework, in which the rule of law, accountable governance and civic freedoms form the crucial underpinning.

This research paper analyses three issues in particular: (i) the case for investors to adopt a more comprehensive approach to their business activities, one that considers civic freedoms as a fundamental part of a stable and sustainable business environment; (ii) barriers to investor engagement in achieving this; and (iii) positive trends and opportunities for investors to explore in this area. The paper then concludes with recommendations for further action on the part of investors, regulators and civil society organizations.

For the purposes of this paper, the term 'investors' covers asset owners and managers in relation to public equity and debt, sovereign wealth funds and private equity. Each type of investor will have different ways of exerting influence, different degrees of leverage, and will face different constraints in their ability to engage on ESG issues. But all have a common stake in the underpinnings of the rule of law, accountable governance and civic freedoms.

Why investors should apply a wider lens to their business activities

Investors have factored political risk into their operations for years, and most understand the importance of good governance to their operational and financial performance. Human rights have also been a concern to socially responsible and faith-based investors for decades. But many mainstream investors do not acknowledge or fully appreciate the connection between civic freedoms and the sustainability and profitability of the broader business environment.

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7 The UN Global Compact (2021), 'The Sustainable Development Goal 16 Business Framework: Inspiring Transformational Governance', https://sdg16.unglobalcompact.org.
8 Glasgow Financial Alliance for Net Zero (undated), 'About Us', https://www.gfanzero.com/about.
9 PWC (2022), *ESG-focused institutional investment seen soaring 84% to US$trillion in 2026, making up 21.5% of assets under management: PwC report*, 10 October 2022, https://www.pwc.com/gx/en/news-room/press-releases/2022/awm-revolution-2022-report.html.

Corrosion of civic freedoms can have a direct effect on the predictability, transparency and stability of the business environment, particularly over the medium to long term. The weakening of political and civic institutions often results in democratic backsliding, raising the level of financial risk.[10] For example, when a government diminishes the powers or independence of the judiciary in a host market, it can shake confidence in the rule of law and may reduce or even deny the availability of effective dispute resolution mechanisms.

Shrinking civic space also creates an 'information black box' for companies and investors alike, reducing transparency and, with it, the ability to assess risks that may be disruptive to business.[11] When illiberal governments restrict access to online services or disrupt networks, as increasingly happens during protests or elections around the world, business and civil society both suffer. Over the long term, an open society with checks on government power is more likely to enable both expression and stability for sustainable capital than a closed society that restricts these freedoms and the flow of information.[12]

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Given this essential connection between business and open societies, and the fact that investors are being asked to take a more active role in geopolitics, recent trends in politics around the world should be a source of concern to investors. Growing illiberalism, populism and polarization have elevated political risk for businesses, including in democracies such as Hungary, India, Israel and Poland. Civic space has shrunk considerably over the last decade,[13] with media freedom declining in a record number of countries.[14] An increasing number of governments worldwide are cracking down on the ability of NGOs to operate and placing online freedom of expression under threat through internet shutdowns and the use of surveillance.[15] These trends are part of a broader pattern involving democratic regression and authoritarian resurgence.[16]

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10 Mosley, L. (2023, forthcoming), 'The Financial and Economic Dangers of Democratic Backsliding', paper prepared for the Capital and Constitution Project, co-sponsored by the Brookings Institution and the States United Democracy Center.
11 ABN Amro, APG, ING, Robeco and Morningstar Sustainalytics (2023), *No news is bad news: Exploring how financial institutions can strengthen human rights risk assessment of business activities in areas where civic space is restricted*, https://assetmanagement.apg.nl/media/gqndx5gl/no-news-is-bad-news-publication.pdf.
12 Freeman, B., Moynihan, H. and Alves Pinto, T. (2021), *The Role of the Private Sector in Protecting Civic Space*, Synthesis Paper, London: Royal Institute of International Affairs, https://www.chathamhouse.org/2021/02/role-private-sector-protecting-civic-space.
13 CIVICUS Monitor (2022), *People Power under Attack*, 16 March 2023, https://monitor.civicus.org.
14 Holmes, O. (2023), 'Media freedom in dire state in record number of countries, report finds', *Guardian*, 3 May 2023, https://www.theguardian.com/media/2023/may/03/media-freedom-in-dire-state-in-record-number-of-countries-report-finds.
15 Shahbaz, A., Funk, A. and Vesteinsson, K. (2022), *Countering an Authoritarian Overhaul of the Internet*, report, Washington, DC: Freedom House, https://freedomhouse.org/report/freedom-net/2022/countering-authoritarian-overhaul-internet.
16 V-Dem Institute (2022), *Autocratization changing nature: Democracy Report 2022*, Gothenburg: V-Dem Institute, https://v-dem.net/media/publications/dr_2022.pdf.

A recent example illustrates the strong link between shrinking civic space and business risk, with investors acting in response. In December 2022, the Israeli government announced proposals to curb the powers of the judiciary by limiting the Supreme Court's power to exercise judicial review, granting the government control over judicial appointments, and limiting the authority of its legal advisers. This initiative not only triggered months of mass protests, but also compelled some venture capital funds to move their money out of Israel due to concerns that the reforms would harm both democracy and the country's economy. In a reflection of how tightening civic space can damage financial prospects, a recent report suggests that £20 billion in capital has been taken out of Israel since the current government took office in December 2022.[17] In April 2023, the credit rating agency Moody's cited deterioration of governance in its decision to downgrade Israel's credit outlook, affecting both the Israeli government (because funding government borrowing is more expensive with a worse credit rating) and Israeli domestic business (which derives its credit rating from the sovereign rating).[18] The IMF has since warned that continued uncertainty could significantly slow Israel's economy.[19]

Focusing on the 'inside out'

The relationship between investors and civic freedoms has two aspects. On the one hand, there is the impact of civic freedoms in a host country on an investor's return on investment ('the outside in'), and on the other, the impact of the investor's activities on the civic space of the host country ('the inside out').

When it comes to the 'outside in', most investors now see mitigating systemic risks as part of risk management, which will improve the overall return of the markets. This represents a move away from 'modern portfolio theory', which focuses on how to create portfolios from capital markets without taking account of global societal risks.[20] There is also growing recognition by investors of the relationship between strong institutions, the rule of law and civic space and their return on investment. SDG 16 (Peace, Justice and Strong Institutions) is directly relevant to civic space, with Target 16.10 committing UN member states to 'ensure public information and protect fundamental freedoms'. In response to a 2020 survey, 84 per cent of investors and ratings agencies stated that business reporting on SDG 16 is 'very relevant' and would provide greater insight into the factors central to a business's ability to succeed.[21] Investors recognize the benefits of markets that feature civil society organizations because the latter encourage greater transparency, expanding information resources beyond those channels that are controlled.

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17 McKernan, B. (2023), 'March of the unicorns: Israel's tech sector rebels against Netanyahu's power grab', *Guardian*, 9 March 2023, https://www.theguardian.com/world/2023/mar/09/israel-tech-sector-rebels-against-netanyahu-power-grab.
18 Wrobel, S. (2023), 'Risk-taking government': Moody's explains fears behind credit outlook downgrade', *Times of Israel*, 18 April 2023, https://www.timesofisrael.com/moodys-warns-of-risks-to-judicial-independence-economic-and-social-stability.
19 Wrobel, S. (2023), 'IMF says uncertainty over judicial overhaul poses 'risks' to Israeli economy', *Times of Israel*, 11 May 2023, https://www.timesofisrael.com/imf-says-uncertainty-over-judicial-overhaul-poses-risks-to-israeli-economy.
20 Lukomnik, J. and Hawley, J. (2021), *Moving Beyond Modern Portfolio Theory: Investing that Matters*, Abingdon: Routledge.
21 swisspeace, engageability and the PeaceNexus Foundation (2020), *Strengthening Corporate Reporting on Sustainable Development Goal 16 Peace, Justice and Strong Institutions: Practice Paper*, November 2020, p. 5, https://peacenexus.org/wp-content/uploads/2020/11/Practice-Paper_Corporate-Reporting-on-SDG16_Nov2020.pdf.

The 'inside out' aspect of investors' relationship with their host environment is reflected in the UN Guiding Principles on Business and Human Rights.[22] Adopted by the UN Human Rights Council in 2011, these principles compel companies and investors not to cause or contribute to adverse human rights impacts through their business operations or relationships, and to carry out due diligence to identify, prevent and mitigate those impacts. This corporate responsibility applies not only to investments in countries, but also to investments in companies that may contribute to undermining civic space and human rights, sometimes acting in concert with a host government. But the 'inside out' aspect currently gets much less attention from investors than the 'outside in'. In practice, there are many businesses that thrive in exploitative environments (at least in the short term) and are willing to engage with, and operate in, countries with illiberal or authoritarian regimes. Given their potential and, at times, demonstrable political and economic clout, investors may exacerbate inequality, human rights abuses and the shrinking of civic space when they turn a blind eye to civic freedoms and invest in countries with repressive governments.

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The importance of the 'inside out' aspect has, however, come into sharper focus as the boundaries between corporate responsibility and geopolitics blur.[23] There are now growing expectations from the public, employees and civil society that business should address geopolitical issues beyond active conflicts,[24] rather than be passive bystanders, and should do so in alignment with international human rights standards. Besides the economic and reputational incentives to support civic space, there are also discretionary opportunities for investors to go beyond mere legal compliance and be proactive,[25] acting as responsible stakeholders that recognize the stake they share in, and the benefits they have gained from, the international rules-based order. This 'geopolitical corporate responsibility'[26] applies not only to multinational corporations but also to institutional investors, who share similar commercial and reputational stakes as they too become enmeshed in geopolitical crises.

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22 United Nations (2011), *Guiding Principles on Business and Human Rights: Implementing the United Nations "Protect, Respect and Remedy" Framework*, https://www.ohchr.org/sites/default/files/documents/publications/guidingprinciplesbusinesshr_en.pdf.
23 Bologna Institute for Policy Research and John Hopkins School of Advanced International Studies (2023), 'Multinational corporations in the vortex of geopolitical ethics and material pressures': lecture by Bennett Freeman, Associate Fellow, International Law Programme, Chatham House, 16 February 2023, https://bipr.jhu.edu/events/4697-Multinational-Corporation-in-the-Vortex-of-ESG-and-Geopolitical-Pressures.cfm.
24 Edelman (2022), *2022 Edelman Trust Barometer Special Report: The Geopolitical Business*.
25 Freeman (2018), *Shared Space under Pressure*.
26 Freeman, B. (2022), 'Geopolitical corporate responsibility can drive change', Chatham House Expert Comment, 26 July 2022, https://www.chathamhouse.org/2022/07/geopolitical-corporate-responsibility-can-drive-change.

In the technology sector, for example, risks to people and to investments are rapidly converging, particularly in the development of AI. Investors have a unique and highly influential role to play in determining whether the behaviour of tech companies is responsible and respects human rights, especially as regulation – which would usually play a safeguarding role – is struggling to keep up with the pace of technological development.[27] For example, spurred by concerns about generative AI such as ChatGPT – including threats to privacy, democracy and even humanity – some large institutional investors, including Aviva, Fidelity International and Legal & General Investment Management, are starting to put pressure on technology companies to strengthen their due diligence and safeguards in relation to the human rights risks of AI.[28]

Barriers and opportunities for broadening investor engagement

But despite the emerging case for corporate responsibility at the geopolitical level, many investors lack a broader perspective that takes into account threats to civic space and freedoms. Part of the problem is that investors and the human rights community speak somewhat different languages: some investors will not even be familiar with the term ‘civil society space’ and, for those that are, the term can be perceived as political, sensitive or vague. Erosion of civic institutions and the shrinking of civil society space are not typically considered as systemic risks that may affect long-term cash flows and projected profits. The ESG and broader sustainability framework, with its language of ‘just transition’, ‘societal resilience’ and ‘equity’, is more accessible to some investors. Yet, the issue of restricted civil society space is critical, and directly related, to issues around equity and just transition, including in the current discussions about loss and damage in the context of climate change.[29] Widening the discourse to include civic freedoms should have some resonance with investors because of the convergence of values and interests, and stakeholder pressures and expectations, that exist around the rule of law and civic freedoms as the essential underpinnings for predictable, sustainable and profitable returns.

Even for those investors that appreciate and acknowledge the connection between civic freedoms and the resilience and profitability of their own operations, there are numerous barriers to investors factoring these issues into their decision-making. These include a lack of incentives to encourage an approach that goes beyond pure credit risk; an absence of criteria and metrics to factor these wider issues into their operations; and a lack of strategic vision, backed up with appropriate governance structures to enable investors to engage purposefully and effectively on these issues.

Lack of incentives to look beyond credit risk

The primary focus of an investor’s business model is the return on investment. This model encourages short-term thinking that focuses only on the ‘outside in’ and does not factor in the broader impacts of deteriorating civil society space.

27 OHCHR (2021), *Rights-respecting investment in technology companies: A B-Tech Briefing*, briefing, January 2021, https://www.ohchr.org/sites/default/files/Documents/Issues/Business/B-Tech/B-Tech-Briefing-Investment.pdf.
28 Bryan, K. (2023), ‘Asset managers pressure tech companies over possible AI misuse’, *Financial Times*, 19 June 2023, https://www.ft.com/content/a6926bb3-5615-4b93-95a8-77db943c7cf1.
29 See, for example, Pettengell, C. (2022), ‘What happened at COP 27?’, *Bond*, 22 November 2022, https://www.bond.org.uk/news/2022/11/what-happened-at-cop27.

Currently, investors will take account of, and react to, major political risks such as changes of government, significant legislative reforms and military control. But their investment decisions are not typically sensitive to other, sometimes more subtle, changes in a political environment that can also be detrimental to financial stability, such as new legislation that makes it harder for NGOs to operate; government clampdowns on independent media; and the arrest of human rights defenders. For example, in March 2022, JP Morgan reacted to Russia's invasion of Ukraine the previous month, a violation of international law that also elevated financial and geopolitical risks, by excluding both Russia and Belarus from its fixed income indexes. But as index providers – which offer a basket, or 'index', of funds for investment and decide which funds to include – grade countries by focusing only on the likelihood that they will default on their debt, they tend to overlook more systemic issues that may affect a country's financial stability, including the erosion of civic institutions and the shrinking of civic space.

Foreign investors such as Blackrock have been increasingly active in China's large bond market in recent years, despite both the imposition in 2020 of the National Security Law in Hong Kong, which has been interpreted broadly as a means to clamp down on those protesting against the government, and China's treatment of the Muslim Uyghur population in Xinjiang province, which an unofficial UK-based tribunal has held constituted genocide.[30] In terms of credit rating, China currently has a good score of A+ on sovereign write-up with S&P Global, because, while the ratings agencies acknowledge issues such as corruption, the policy outcomes in terms of growth and fiscal position have been generally good.

Even for those investors that have concerns about deterioration of the rule of law and civic space in a host market, legal and operational factors may disincentivize engagement on these issues – or at least make it more difficult. The position of HSBC in Hong Kong exemplifies some of the conflicting values and interests that investors and companies may have to deal with in politically sensitive situations. In 2020, Aviva Investors – the holder of shares worth nearly £800 million in HSBC and Standard Chartered – expressed unease at the decision of these two banks to support the National Security Law. Aviva stated that it expected 'both companies to confirm that they will also speak out publicly if there are future abuses of democratic freedoms connected to this law'.[31] In the case of HSBC, Hong Kong is its largest market, where it employs approximately 30,000 people, and the bank must comply with local law to be able to operate there. At the same time, HSBC and other banks have faced criticism not only from human rights groups but also from UK ministers and parliamentarians.[32] A 2023 inquiry by the All-Party Parliamentary Group on Hong Kong concluded that 'British banks such as HSBC Bank PLC have been complicit in supressing the human rights of Hongkongers, by proactively supporting the National Security Law.'[33]

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30 Wintour, P. (2021), 'Uyghurs subjected to genocide by China, unofficial UK tribunal finds', *Guardian*, 9 December 2021, https://www.theguardian.com/world/2021/dec/09/uyghurs-subjected-to-genocide-by-china-unofficial-uk-tribunal-finds.
31 Bray, C. (2020), 'Aviva Investors Rebukes HSBC, Standard Chartered over Decision to Support Hong Kong National Security Law', *South China Morning Post*, 10 June 2020, www.scmp.com/business/banking-finance/article/3088392/aviva-investors-rebukes-hsbc-standard-chartered-over.
32 Reuters (2020), 'Don't sacrifice Hong Kong for a banker's bonus, UK tells HSBC', 1 July 2020, https://www.reuters.com/article/hongkong-protests-britain-banks-idINKBN2425VY.
33 All-Party Parliamentary Group on Hong Kong (2023), *Inquiry into British Banks operating in Hong Kong*, report, February 2023, https://www.hkinquiry.org/banking-report, p. 15.

Privately, many investors and companies are increasingly concerned about the closing of civic space in Hong Kong. Until recently, Hong Kong was home to strong civil society organizations, which provided useful alternative sources of information on listed companies, otherwise covered only superficially by mainstream media outlets. But these alternative sources are steadily disappearing. The rule of law and the independence of Hong Kong's judiciary – historically pivotal to the territory's appeal to the international business community due to the transparency and predictability that they provide – are now under threat.

With the shrinking of civic space through the repressive implementation of the National Security Law has come a marked increase in business risk. A March 2023 report by the Atlantic Council detailed how Hong Kong's diminishing political independence and 'fractured foundations' – including the targeting of independent media, pro-democracy politicians and publishers of books and films – are negatively affecting the business sector.[34] Threats to journalism have resulted in a lack of the information needed for the operation of financial markets, as well as risks to the accessibility of broader information flows necessary in a modern economy such as reporting on economic data and corporate financial results.[35] The National Security Law also poses data security risks for financial services providers, including risks to intellectual property, online speech and the privacy of customer information.[36] Coupled with the disappearance of leading Chinese entrepreneurs (including, most recently, tech CEO Bao Fan in February 2023), the closing of civic space is leading some investors to move their money out of not only Hong Kong but also mainland China.[37]

Regulatory pressure

A convergence of pressure points is incentivizing investors to undertake a more thorough assessment of the environments in which they operate. One major factor is the accelerating regulation of human rights, ESG and sustainability issues across many countries and stock exchanges, along with the degree of specificity required in related disclosure regimes. Increasingly, governments are enacting regulation to focus investors and companies on a company's impact on the world at large, and to provide checks on corporate power and routes for accountability by requiring business to carry out due diligence on the human rights implications of their operations. In the last few years, several countries have adopted laws mandating human rights and environmental due diligence, including Germany, the Netherlands and Norway. Australia, Canada, Denmark, France, Japan, Switzerland, the US and the UK have also all passed or proposed laws on human rights due diligence, supply-chain transparency or modern slavery.[38]

34 Wright, L. (2023), 'Fractured foundations: Assessing risks to Hong Kong's business environment', Atlantic Council, 7 March 2023, https://www.atlanticcouncil.org/in-depth-research-reports/report/fractured-foundations-assessing-risks-to-hong-kongs-business-environment.
35 Ibid.
36 Ibid.
37 Sender, H. (2023), 'The cloud over China's entrepreneurs raises capital flight risk', *Financial Times*, 27 March 2023, https://www.ft.com/content/d5346367-c623-4348-a0b8-1cb4fea55706.
38 See the Business & Human Rights Resource Centre's mandatory human rights due diligence portal, which collects news on all national and regional developments: https://www.business-humanrights.org/en/big-issues/mandatory-due-diligence.

In the EU, the concept of 'double materiality' – which refers to how information disclosed by a company can be material in terms of its implications for both the company's financial value and its impact on the world – has been incorporated into the regulatory framework for sustainability reporting. This ensures that both the 'inside out' and 'outside in' aspects of a business's relationship with society are factored into EU sustainability standards and disclosure requirements. Since March 2021, EU rules have required fund managers to disclose how they account for the ESG impacts of their investments. The EU's forthcoming Corporate Sustainability Due Diligence Directive will impose obligations on in-scope companies to establish a human rights due diligence plan and monitoring mechanism. On 1 June 2023, the European Parliament approved the directive and confirmed that financial institutions will be covered by the rules (a position which also requires confirmation from the European Council).[39] Where relevant, the directive will require investors to engage in efforts to either minimize the extent of adverse impacts by investee companies or to bring such impacts to an end. The draft directive seeks to hold in-scope financial institutions accountable both through administrative supervision (member states must designate an authority to supervise and impose effective, proportionate and dissuasive sanctions, including fines and compliance orders) and the establishment of a link to corporate civil liability for damages.[40]

While the exact requirements of the legislation above may vary, all are grounded in the international human rights standards set out in the UN Guiding Principles on Business and Human Rights and the OECD Guidelines for Multinational Enterprises,[41] which provides a degree of regulatory coherence. These standards can be useful for both companies and investors in providing legal cover from host country government requests – for example, to pay bribes or be complicit in human rights abuses. In addition, just as there has been a sharp rise in litigation seeking to hold companies to account for their behaviour on environmental issues in the last five years,[42] as human rights due diligence regulation becomes entrenched, we can also expect to see increasing strategic litigation that seeks to hold businesses and investors to account for their human rights policies, including in relation to civic freedoms.

Sanctions are also forcing investors and companies to pay closer attention to civic freedoms and to their position of responsibility in the broader geopolitical ecosystem. In Belarus, where the government has aggressively clamped down on peaceful protestors, EU sanctions imposed in June 2021 prevent European investors from buying or trading any new Belarusian bonds. Many Swiss banks have Russian clients, but such relationships pose a growing financial and reputational risk, especially after the imposition by the Swiss government of sanctions on Russian assets in the

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39 Gambetta, G. (2023), 'Landmark sustainability due diligence directive passes European Parliament vote', Responsible Investor, 1 June 2023, https://www.responsible-investor.com/landmark-sustainability-due-diligence-directive-passes-european-parliament-vote.
40 European Commission (2022), 'Corporate sustainability due diligence: fostering sustainability in corporate governance and management systems', https://commission.europa.eu/business-economy-euro/doing-business-eu/corporate-sustainability-due-diligence_en.
41 OECD (2011), *OECD Guidelines for Multinational Enterprises*, Paris: OECD Publishing, https://www.oecd.org/daf/inv/mne/48004323.pdf.
42 Guruparan, K. and Moynihan, H. (2021), *Climate change and human rights-based strategic litigation*, Chatham House Briefing Paper, 11 November 2021, https://www.chathamhouse.org/2021/11/climate-change-and-human-rights-based-strategic-litigation.

wake of the invasion of Ukraine.[43] As part of the Summit for Democracy hosted by the US government in March 2023, both governments and tech investors came under pressure to prioritize human rights due diligence on spyware technology,[44] which has been used around the world to target activists and journalists. In parallel, US president Joe Biden issued an executive order prohibiting the use of commercial spyware.[45]

Collaboration with civil society organizations

As a result of sustained advocacy and engagement by the Investor Alliance for Human Rights (IAHR),[46] some institutional investors have taken a joint stand in response to threats to human rights, including civic freedoms. For example, in December 2021, a group of 30 investors joined international calls for the full restoration of the democratic transition in Sudan with respect to the rule of law, accountable governance and civic freedoms, following the October 2021 military-led coup.[47] In May 2023, the IAHR, together with the EIRIS Conflict Risk Network and the Heartland Initiative, issued a press release in response to the escalating violence between military factions in Sudan, stating that 'the restoration of the political transition towards an inclusive, civilian, democratic government underpinned by respect for fundamental rights and freedoms is essential to a stable and prosperous Sudan with a thriving civil society and economy'.[48]

Collective investor statements have had a tangible impact on corporate engagement on the civic freedoms of expression, association and assembly in several cases in recent years. Examples include shareholders of Amazon supporting a resolution on freedom of association,[49] and investors in Starbucks approving a bid to review the company's principles of freedom of association.[50] Shareholder pressure also pushed Apple into publishing a human rights policy that committed to respecting freedom of information and expression, after years of criticism of the company for its acquiescence in Chinese government demands to limit freedom of expression (for example, by deleting over 600 virtual private networks from its App Store).[51]

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43 Jones, S. (2022), 'Long shadow of Russian money raises tricky questions for Swiss bankers', *Financial Times*, 20 June 2022, https://www.ft.com/content/2c7128d0-b5fc-4d1b-bf95-49a886e28d17.
44 Business & Human Rights Resource Centre (2023), 'Governments and tech investors under pressure to act on unlawful and arbitrary use of spyware', press release, 24 March 2023, https://www.business-humanrights.org/en/from-us/media-centre/governments-and-tech-investors-under-pressure-to-act-on-unlawful-and-arbitrary-use-of-spyware.
45 The White House (2023), 'Executive Order on Prohibition on Use by the United States Government of Commercial Spyware that Poses Risks to National Security', 27 March 2023, https://www.whitehouse.gov/briefing-room/presidential-actions/2023/03/27/executive-order-on-prohibition-on-use-by-the-united-states-government-of-commercial-spyware-that-poses-risks-to-national-security.
46 The IAHR is a collective action platform for responsible investment grounded in the international human rights framework that works with over 220 institutional investors. See IAHR (undated), 'Who We Are', https://investorsforhumanrights.org/about.
47 EIRIS Conflict Risk Network, Investor Alliance for Human Rights and Business & Human Rights Resource Centre (2021), 'Leading investors support democratic transition in Sudan', press release, 8 December 2021, https://eiriscrn.net/wp-content/uploads/2021/12/Press-Release-Sudan-Investor-Statement.pdf.
48 IAHR (2023), 'Joint Statement on the Situation in Sudan', press release, 5 May 2023, https://investorsforhumanrights.org/news/joint-statement-situation-sudan.
49 SHARE (2022), 'Shareholders deliver rebuke to Amazon for practices called "waste of time and money"; support resolution on freedom of association', 30 May 2022, https://www.prnewswire.com/news-releases/shareholders-deliver-rebuke-to-amazon-for-practices-called-waste-of-time-and-money-support-resolution-on-freedom-of-association-301557364.html.
50 Geraldo, R. (2023), 'Starbucks investors approve bid to review labor practices', *Seattle Times*, 4 April 2023, https://www.seattletimes.com/business/starbucks/starbucks-investors-approve-bid-to-review-labor-practices.
51 McGee, P. (2020), 'Apple commits to freedom of speech after criticism of China censorship', *Financial Times*, 4 September 2020, https://www.ft.com/content/a88f5d3d-0102-4616-8b3f-cb0661ba305d.

Engagement on civic freedoms varies significantly according to the type of investor. Faith-based investors, those able to take a longer-term view and public markets with greater disclosure obligations are more likely to be responsive than private markets, which are not required to make disclosures. Public-facing institutional investors, such as pension funds, increasingly factor risks to human rights and civil society space into their decision-making. For example, in 2021, a group of Danish asset managers sold all their Belarus government debt on human rights grounds and excluded 45 countries, including China, Saudi Arabia and Venezuela, due to demands from members that human rights should be a priority.[52] Germany's Union Investment also divested from Belarusian funds and declined to buy Tajikistan's bonds due to human rights abuses.[53]

However, when public funds divest, private capital will sometimes buy the assets, which can simply make the underlying problem less visible, rather than addressing it. There is also a growing trend for large pension funds to invest in private equity funds, which lag behind larger institutional investors on attention to human rights, including civic freedoms. For example, private equity and venture capital firms play an important role in funding the technology sector, but often without due regard for the impact their funding may have on civic freedoms. Amnesty International's 2021 report *Risky Business: How Leading Venture Capital Firms Ignore Human Rights When Investing in Technology* highlighted that eight out of 10 venture capital firms showed no evidence that they check whether their investments could be linked to human rights abuses.[54] Silicon Valley investors avoided Saudi Arabia after the murder of Saudi journalist and dissident Jamal Khashoggi in 2018, but now leading venture capital firms are again accepting substantial investments from Saudi Arabia's Public Investment Fund.[55]

In the last few years, civil society organizations have strengthened their engagement with venture capital and private equity firms to increase awareness of human rights and civic freedoms and help guide private investors on how to meet their responsibilities. For example, the UN Principles for Responsible Investment (PRI), which encourages collaborative engagement by investors on human rights and civic space issues, has recently focused on how to improve human rights due diligence in private markets.[56]

It is becoming increasingly risky – legally, reputationally and financially – for investors to focus solely on short-term profits – or profits plus 'tick-box' ESG and sustainability efforts – as opposed to adopting a broader and longer view informed by human rights due diligence that extends to civic freedoms and wider geopolitical risks. This applies equally to private investors. For example, private equity firm Novalpina Capital was involved in financing the Israeli company NSO Group,

52 Fletcher, L. and Stubbington, T. (2021), 'ESG investing: funds weigh sovereign debt profits against human rights', *Financial Times*, 13 July 2021, https://www.ft.com/content/bd2e752e-5afa-424a-af7e-433963dd7c34.
53 Ibid.
54 Amnesty International (2021), *Risky Business, How Leading Venture Capital Firms Ignore Human Rights When Investing In Technology*, report, July 2021, https://www.amnestyusa.org/wp-content/uploads/2021/07/Risky-Business-How-Leading-VC-Firms-Ignore-Human-Rights-When-investing-in-Tech-Final-1.pdf.
55 Guyer, J. (2023), 'How Saudi money returned to Silicon Valley', Vox, 1 May 2023, https://www.vox.com/technology/2023/5/1/23702451/silicon-valley-saudi-money-khashoggi.
56 PRI (2022), *Human Rights in Private Markets: Identifying and Assessing Negative Human Rights Outcomes*, https://www.unpri.org/human-rights/human-rights-in-private-markets-identifying-and-assessing-negative-human-rights-outcomes/10371.article.

maker of 'Pegasus' spyware. In July 2021, a group of media organizations revealed how Pegasus was being used by certain governments to spy on journalists around the world, as well as targeting leading politicians and activists in several countries. The US responded in November 2021 by sanctioning NSO Group, since when the company's value has become almost worthless to its private equity backers.[57]

Other pressure points

Pressure on investors to think more proactively about the societies with which they interact is also growing from the public and from within organizations – both employees and business leaders. Demographics are an important factor in this evolving landscape. Recent data suggests that millennial investors care more than older generations about social issues.[58] Among Gen Z (usually defined as those currently aged between 18–25), trust in government and media is fading, but that cohort believes that big institutions have the responsibility to act and that businesses need to improve.[59] Gen Z is 92 per cent more likely to protest than older generations,[60] and can do so more quickly, visibly and extensively, using social media and the internet to mobilize around social issues, including civic freedoms. Investment firms with explicit social purpose are more likely to attract talent from some universities. Younger generations are also more likely to seek jobs elsewhere if their employer does not align with their personal views and values, regardless of whether these issues are part of their employer's core business.[61]

Pressure on investors to think more proactively about the societies with which they interact is also growing from the public and from within organizations – both employees and business leaders.

Some large and well-known investors are showing leadership in this area. For example, in 2023, Dutch bank ABN Amro convened other financial institutions to work with the Business & Human Rights Resource Centre (a leading civil society organization focusing on business and human rights) on a report that explored how financial institutions can strengthen human rights risk assessment of business activities in areas where civic space is restricted.[62] Norway's sovereign wealth fund, Norges Bank Investment Management (NBIM) – the world's largest single investor, with assets under management in excess of $1 trillion – has a Council on Ethics, which recommends exclusion of companies from investment if they raise concerns about human rights or civic space. For example, in the past year, NBIM has placed Polish energy company Polski Koncern Naftowy Orlen SA under observation over

57 Wiggins, K. (2022), 'NSO Group deemed 'valueless' to private equity backers', *Financial Times*, 11 April 2022, https://www.ft.com/content/24584247-0fd4-4826-bcac-f726ad17af58.
58 Tett, G. (2021), 'Millennial Philanthropy May Forever Change Finance', *Financial Times*, 6 May 2021, https://www.ft.com/content/bb84572b-89bc-4cc3-9d0c-5e6121b04191.
59 Oliver Wyman Forum and The News Movement (2023), *What business needs to know about the generation changing everything: A-Gen-Z-Report*, https://www.oliverwymanforum.com/content/dam/oliver-wyman/ow-forum/template-scripts/a-gen-z/pdf/A-Gen-Z-Report.pdf, p. 9.
60 Ibid., p. 46
61 Ibid., p. 51.
62 ABN Amro et al. (2023), *No news is bad news*.

concerns that it was responsible for human rights violations via its ownership of dozens of Polish media outlets, with the company being accused of increasing government power over the media in that country.[63] NBIM also excluded an Israeli software company over concerns that customers of its surveillance products have been accused of serious human rights violations and two Thai companies for activities that provide the Myanmar armed forces with significant revenue that could be used to finance human rights abuses.[64]

It is striking, however, that most of the positive examples of engagement come from Europe and the UK, where both the international human rights law framework is well entrenched (including through EU and UK law, and the Council of Europe's European Convention on Human Rights, supervised by the European Court of Human Rights) and ESG investing is more mature. ESG investing continues to grow in Asia,[65] but a backlash from the political right in the US (with the support of the oil and gas lobby) has mobilized politicians in 24 Republican-controlled states to agitate against the concept. President Biden recently issued his first veto to block a Republican attempt to overturn a federal Department of Labor rule allowing investment managers to consider ESG risks in their investment decisions.[66]

Lack of metrics

Another barrier to investor engagement is that these broader issues are not easy for investors to measure or quantify, or at least not in a way that fits neatly into their standard methodologies. Conversely, ESG ratings have been designed to suit investors' way of working – which include the use of numbers, standards and metrics to help them assess and quantify risk. In the last five years, the rapidly evolving ESG landscape has produced a proliferation of standards, standards bodies, data analytics and assessment scores to assist investors in their analysis of 'E', 'S' and 'G' issues.

But while these developments have produced more information for investors, they have also resulted in a wide variety of metrics, methodologies and approaches that are not globally coherent,[67] leading to a crowded and complex environment. The ESG framework faces growing criticism for inconsistent criteria and metrics, the conflation of distinct issues, and misleading portfolio construction and fund marketing. Bodies such as the International Sustainability Standards Board (ISSB) are making significant efforts to improve the quality and consistency of the ESG data landscape.[68] In June 2023, the ISSB launched the International Financial

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63 Notes from Poland (2023), 'Norway wealth fund puts Polish state oil firm "under observation for serious human rights violations"', 23 February 2023, https://notesfrompoland.com/2023/02/23/norway-wealth-fund-puts-polish-state-oil-firm-under-observation-for-serious-human-rights-violations; NBIM (2023), 'Decision on observation', press release, 22 February 2023, https://www.nbim.no/en/the-fund/news-list/2023/decision-on-observation.
64 Kalia, S. (2022), 'Norway sovereign wealth fund drops Thai, Israeli firms on rights concerns', Reuters, 16 December 2022, https://www.reuters.com/business/sustainable-business/norway-sovereign-wealth-fund-excludes-firms-it-says-may-contribute-rights-2022-12-15.
65 Accenture (2022), *The Rise of ESG Investing in Asia*, report, https://www.accenture.com/content/dam/accenture/final/industry/capital-markets/document/Accenture-Wealth-Management-Asia-ESG-Investing-Good-to-Grow.pdf.
66 The White House (2023), 'Statement by President Joe Biden on his veto of HJ Resolution 39', 16 May 2023, https://www.whitehouse.gov/briefing-room/statements-releases/2023/05/16/statement-from-president-joe-biden-on-his-veto-of-h-j-res-39.
67 Boffo, R. and Patalano, R. (2020), *ESG Investing: Practices, Progress and Challenges*, report, Paris: OECD Publishing, https://search.oecd.org/finance/ESG-Investing-Practices-Progress-Challenges.pdf.
68 See also efforts by the UK's Financial Reporting Council (2021), 'FRC Statement of Intent on Environmental, Social and Governance Challenges', https://www.frc.org.uk/getattachment/691f28fa-4af4-49d7-a4f5-49ad7a2db532/FRC-LAB-ESG-Paper_2021.pdf.

Reporting Standards' (IFRS) Sustainability Disclosure Standards, with the aim of creating a global baseline of high-quality sustainability information for investors, and thus a more coherent approach to sustainability reporting worldwide. This represents an important step forward. At the same time, the ISSB's approach focuses solely on sustainability-related impacts material to the company (i.e. the 'outside in' or 'single materiality'). This approach differs from that of the EU in its development of standards through the European Financial Reporting Advisory Group, which require double materiality (as noted above).[69] Efforts to improve sustainability disclosures also need to ensure that what is deemed to fall within the 'S' in ESG, or under the social aspect of the 'sustainability' umbrella, goes beyond an important but narrow subset of issues, such as supply-chain transparency, modern slavery and workers' rights, to also take into account the health of civic freedoms and the rule of law.

Current ESG and sustainability ratings systems are not designed to pick up broader, and often more insidious, risks to civic freedoms that are nevertheless material to investors. These can include diminishing flows of information and declining predictability following, for example, a government crackdown on media freedom or the targeting of human rights defenders. ESG ratings can even be detrimental, insofar as they may suggest that a company is compliant on 'E' or 'S' issues when it is not.[70] A recent study by Inclusive Development International found that many ESG funds were investing in companies linked to entities with egregious human rights records, including the Myanmar military.[71] That study also argued that index providers like S&P, FTSE Russell and MSCI – which have significant leverage as gatekeepers to trillions of dollars of sustainable capital – use flawed ratings to create ESG indexes, contributing to increasing misalignment between ESG practices and respect for human rights, including civic freedoms.[72]

Plugging the information gap

Investors need to assess and measure both the way in which the openness of a host country may affect their return on investment, and the wider impact of their own investment activities on the rule of law and civic space. For investors in listed equities, responsible stewardship should involve detailed testing and monitoring of company commitments against both internal information and externally sourced data that specifically identify human rights risks in the host country. The Corporate Human Rights Benchmark provides useful analysis of the track record of companies on freedom of association and freedom of assembly, alongside other human rights, and the civil society organization Ranking Digital Rights evaluates and ranks

69 European Commission Newsroom (2022), 'Political agreement on Corporate Sustainability Reporting Directive will improve the way firms report sustainability information', article, 26 July 2022, https://ec.europa.eu/newsroom/fisma/items/754701/en.
70 See, for example, Inman, P. (2023), 'Green investment funds pushing money into fossil fuel firms, research finds', *Guardian*, 2 May 2023, https://www.theguardian.com/business/2023/may/02/green-investment-funds-pushing-money-into-fossil-fuel-firms-research-finds.
71 Pred, D. and Bugalski, N. (2022), 'Why ESG investing is bad for human rights – and what we can do about it', Business & Human Rights Resource Centre, 21 March 2022, https://www.business-humanrights.org/en/blog/why-esg-investing-is-bad-for-human-rights-what-we-can-do-about-it/#:~:text=That's%20because%20ratings%20firms%20amalgamate,commitment%20or%20gender%20equity%20policy.
72 Muñoz Quick, P. (2022), 'Bridging the human rights gap in ESG investing', BSR, 14 April 2022, https://www.bsr.org/en/blog/bridging-the-human-rights-gap-in-esg.

digital companies in relation to online freedom of expression, information and privacy. The rapid changes in the regulation of corporate disclosures described in this paper will also help plug some data gaps for investors.

Investors in government debt and index providers featuring country funds need specific data on the country concerned. There is now a wealth of such information available to investors, but current human rights due diligence efforts often overlook civic space issues. As part of their evaluation of risks to human rights and society, investors should have regard to well-reputed data sources on the state of civic freedoms in each country, such as Freedom House, the Varieties of Democracy Institute (V-Dem) and CIVICUS Monitor. Social media analysis on controversies, discussions with affected stakeholders and country reports by certain governments are also important sources of information on the state of civic freedoms and rule of law in a particular country.

Data are typically less available and less reliable in authoritarian or politically turbulent societies, precisely because of the shrinking of civil society in those countries. In such countries, human rights defenders have a particularly significant role as the 'canary in the coalmine', alerting investors and companies to the situation on the ground. Platforms such as the IAHR and PRI can help investors by highlighting reports from human rights defenders and exploring practical ways to strengthen risk assessments in areas where civic space is restricted.

The PRI cites as a model of best practice Sweden's Andra AP-Fonden (AP2) pension fund, which has developed a country framework to systematically identify any financial, operational or human-rights-related reasons not to invest in certain countries. This framework involves AP2 using third-party quantitative analysis of multiple datasets to screen all countries for human rights violations to identify those ranked lowest for protecting human rights. The data draw on many sources recommended by the PRI,[73] as well as on press articles and information from country-specific non-governmental organizations. For each country flagged, a deeper qualitative analysis is carried out to better understand the human rights situation. This step often entails discussions with experts at think-tanks, specialized data providers and political analysts.[74] This methodology has the advantage of being scalable over time by other investors.

Implementation of such systems takes time and resources, but increasing support is available to investors from civil society organizations. Over the longer term, the additional time and resources devoted to proper due diligence will lead to lower financial and legal risks, as well as the reputational benefits of being considered a responsible stakeholder.

Difficult dilemmas require strong governance

Even with more useful and comprehensive data in place, making the link between investment and shrinking civic space can be difficult, not least because it touches on host government discretion over social and political issues. Investors may not

73 See Step 2 ('Due Diligence') in PRI (2022), 'Human rights in sovereign debt', 12 January 2022, https://www.unpri.org/sovereign-debt/human-rights-in-sovereign-debt-the-role-of-investors/9151.article.
74 PRI (2023), 'Case Study: AP2: Country-level framework to assess human rights', 24 January 2023, https://www.unpri.org/human-rights/ap2-country-level-framework-to-assess-human-rights/11064.article.

want to risk their position in a particular market by taking a public stance on civic freedoms, which can appear more politically contentious than, for example, carbon emissions. Investors will also be conscious of the need to work with different political systems and values, and to comply with local law.

Insofar as investors can exert leverage, they will sometimes need to make trade-offs or difficult choices about whether to speak up, divest or try to influence change in other ways. While divestment can be appropriate in some circumstances, it can increase political tensions, as well as involve the loss of influence in the company or country concerned. In January 2022, for example, Total Energies and Chevron withdrew from the Yadana offshore gas project in Myanmar due to the human rights situation and the deteriorating rule of law. But many companies remain in that country, with some arguing that pulling out would do more harm than good to communities on the ground, because exiting takes investment out of the local economy.[75]

In some cases, investors may be prepared to make public statements about threats to civic freedoms, especially if acting in alliance with others.

In response to the Russian invasion of Ukraine in February 2022, many investors and companies withdrew from Russia, some at huge financial cost. In June 2022, a group of 59 investors issued a statement condemning Russia's invasion and calling on companies with business relationships in Belarus, Russia and Ukraine to align their operations with the UN Guiding Principles on Business and Human Rights.[76] However, as of February 2023, 1,717 international companies were still operating in Russia, while only 644 companies had committed to fully withdraw from the country.[77] B4Ukraine, a worldwide coalition of civil society organizations, has appealed to those companies still present in Russia to terminate or suspend their business operations and relationships in light of Russia's violations of international law, and to carry out due diligence on exiting responsibly.[78] But in practice, many entities trying to sell Russian assets have been obstructed by new Russian legislation that makes such deals subject to Kremlin approval.[79]

In some cases, investors may be prepared to make public statements about threats to civic freedoms, especially if acting in alliance with others. For example, some major institutional investors and banks joined a coalition of business leaders to call publicly for the peaceful transfer of power after the 2020 US presidential

75 Reed, J. (2022), 'Stay or go: the dilemma for multinationals in Myanmar', *Financial Times*, 25 January 2022, https://www.ft.com/content/f8f9ba4e-296c-4c44-bd3a-343b55837695.
76 Heartland Initiative (2022), 'Investor Statement on the Crisis in Ukraine', press release, 5 June 2022, https://www.heartland-initiative.org/investor-statement-on-the-crisis-in-ukraine.
77 B4Ukraine (2023), *Unfinished Business: International business exits from Russia since the beginning of the full-scale invasion of Ukraine*, report, 14 February 2023, https://b4ukraine.org/pdf/B4Ukraine_Unfinished_Business.pdf.
78 Business & Human Rights Resource Centre (2022), 'Coalition of CSOs calls on companies operating in Russia to terminate or suspend operations immediately', 21 July 2022, https://www.business-humanrights.org/en/latest-news/b4ukraine-declaration-on-russian-invasion-of-ukraine.
79 Walker, O. (2023), 'Western banks struggle to exit Russia and Putin intervention', *Financial Times*, 16 January 2023, https://www.ft.com/content/98f91997-db83-4a23-8497-9348c7e7247f.

election.[80] In 2019, major Dutch institutional investors appealed to Shell to bring pressure on Brunei Darussalam over a proposed law mandating the death penalty for homosexuality. Leading investment banks such as JP Morgan also boycotted hotels owned by the Sultan of Brunei;[81] the legislation was eventually abandoned. But supporting civic freedoms does not always have to mean stark choices or overt public messaging. In some cases, investors and companies can exert influence discreetly. Private negotiations may enable organizations to continue operations while balancing civic values and business interests.

While investor engagement on civic freedoms will sometimes be complex and challenging, there will also be more straightforward situations. For example, all investors should pay close attention to direct or indirect efforts by companies to stifle opposition to their operations through 'strategic lawsuits against public participation' (SLAPPs) and other tactics used to silence NGOs and human rights defenders. In 2021, the IAHR coordinated an investor statement on SLAPPs, in which 44 institutions with combined assets of more than $270 billion called on companies to take broad, systemic action to protect human rights defenders, and immediate action to ensure that they do not use or support SLAPPs against individuals, organizations, or communities peacefully promoting or protecting human rights and the environment.[82]

To navigate the dilemmas involved in being a responsible geopolitical stakeholder, corporate and investment CEOs and directors need strong public policy judgement, the ability to take a long-term view and to balance stakeholder expectations against the reactions of host governments they may be compelled to challenge. From a governance perspective, it is important that those working on sustainability and ESG issues include the rule of law and civic space in their analysis of both human rights and geopolitical risks, and that they report to senior leadership on these issues. Investors should also join reputable industry bodies and collaborate with civil society organizations that can help investors to identify and navigate the dilemmas and risks posed by shrinking civic space.

In this respect, the ABN Amro-led report cited earlier in this paper recommended the development of working groups that bring together financial institutions, ESG data providers, academics and civil society organizations to regularly discuss human rights concerns in various geographies with civic space restrictions.[83] Platforms such as the PRI, IAHR and the Business Network on Civic Freedoms and Human Rights Defenders, as well as independent think-tanks such as Chatham House, are well placed to promote greater cooperation and trust among investors and other stakeholders through multi-stakeholder dialogue, which can also help reduce the risk of different actors talking past each other.

80 Moynihan, H. and Freeman, B. (2020), 'Corporate Big Beasts Stick Their Necks Out For Democracy', Chatham House Expert Comment, 16 December 2020, https://www.chathamhouse.org/2020/12/corporate-big-beasts-stick-their-necks-out-democracy.
81 Morris, S. and Vandevelde, M. (2019), 'JP Morgan bans staff from Brunei-owned hotels over gay law', *Financial Times*, 29 April 2019, https://www.ft.com/content/b0365536-69ca-11e9-80c7-60ee53e6681d.
82 IAHR (2021), 'Investor Statement on SLAPPs', press release, 11 June 2021, https://investorsforhumanrights.org/investor-statement-strategic-lawsuits-against-public-participation.
83 ABN Amro et al. (2023), *No news is bad news*.

Conclusion and recommendations

At a time when the world is facing a 'polycrisis' of economic uncertainty, climate change and growing illiberalism, investors need stability and predictability more than ever – just as the civic space and freedoms that underpin and facilitate that stability need the support of investors. Investors should consider their investment decisions in a broader context that is integrated with the global and local challenges in which they are stakeholders, and grounded in a recognition that support for the rule of law and civic freedoms is in the common interest.

But making the link between the shrinking of civic space and the impact on investors' long-term cash flows, returns and strategies will be a continuing challenge. While instances of investor action in support of civil society space can be cited, progress should be measured not by a few positive examples but by investor actions across the spectrum. On this basis, more work needs to be done to raise investor awareness and mainstream consideration of the rule of law, accountable governance and civic freedoms into investors' activities, as opposed to the current somewhat patchy, siloed and superficial approaches to 'E', 'S' and 'G'.

It would be naive to expect that such a change will happen overnight or without serious resistance from some (often influential) shareholders who continue to focus almost entirely on short-term financial gain. But, while consideration of human rights and civic freedoms may seem new or niche to some, investors' increased focus on them is a growing trend that is not going away.[84] The raft of new regulation and standards on sustainability, together with pressures from younger generations, employees and civil society, will only increase pressures on investors and companies to live up to their responsibilities as geopolitical stakeholders with increasing power and leverage in the global governance ecosystem.

The following recommendations emerged from conversations with a range of investors and stakeholders.

For investors

- Strengthen human rights due diligence to include assessment of risks to the rule of law, accountable governance and civic space in the investment environment, especially in areas where civic space is restricted. The human rights due diligence methodology adopted by the Swedish AP2 pension fund (see p. 16) provides a useful model;
- Engage portfolio companies on those risks to civic freedoms and space that are most pressing, particularly in sectors and countries with significant exposure. Shareholders should file/co-file resolutions where there are concerns around civic freedoms, or at least vote favourably via proxy on resolutions filed by others;
- Urge index providers to add political and social risk more explicitly and consistently into decisions on inclusion;

84 Kenway, N. (2022), 'Reflecting on a year in ESG… and predictions for 2023', ESG Clarity, https://esgclarity.com/reflecting-on-a-year-in-esg-and-predictions-for-2023.

- Participate in dialogue and partnership with other stakeholders, including joining multi-stakeholder initiatives and coalitions, and be open to constructive challenge from civil society organizations; and
- Develop a public statement opposing the use by companies of SLAPPs to silence critics and degrade civic freedoms.

For regulators

- Push for the application of 'double materiality' standards that enable investors to account for both the 'inside out' and 'outside in' aspects of their relationship with society in their risk assessments, and not just financial materiality;
- Support the development of harmonized standards, both by referring to the UN Guiding Principles on Business and Human Rights in national and supranational laws and by coordinating with other stakeholders, with a view to working towards a more coherent regime at the global level;
- Help investors to plug data gaps by referring to civic space and human rights defenders in human rights due diligence laws, and by mandating meaningful stakeholder engagement; and
- Encourage investors to take account of well-reputed data sources from NGOs that benchmark human rights, including restrictions on civic freedoms.

For civil society organizations

- Increase investor awareness of these issues through collaboration and training. Investor training on ESG and sustainability should include not only human rights issues but also the broader underpinnings of the rule of law, civic space and accountable governance;
- Account for investor priorities and methodology when engaging investors on threats to civic space, to help find ways to bridge the language and culture gaps between civil society and some investors; and
- Intensify work attuning private investors to the link between open societies and stable investment, as private investors typically lag behind public funds in awareness and efforts on human rights, including civic freedoms.

About the author

Harriet Moynihan is an associate fellow in the Chatham House International Law Programme. Her research focuses on business and human rights, the application of international law to cyberspace, and the role of international human rights law in internet governance. Harriet has a master's degree in international human rights law from the University of Oxford and was a visiting fellow at the Bonavero Institute of Human Rights and Mansfield College, University of Oxford, in 2019.

Prior to joining Chatham House, Harriet was a legal adviser at the UK Foreign & Commonwealth Office, where she advised on a wide range of public international law issues and represented the UK on legal issues in bilateral and international forums. Before that, Harriet was a competition lawyer at Clifford Chance LLP, where she worked in the firm's London and Singapore offices.

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The views expressed in this publication are the sole responsibility of the author.

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Cover image: Demonstrators rally against the Israeli government's plan to overhaul the judicial system, Tel Aviv, Israel, 27 May 2023.
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The Royal Institute of International Affairs
Chatham House
10 St James's Square, London SW1Y 4LE
T +44 (0)20 7957 5700
contact@chathamhouse.org | chathamhouse.org

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