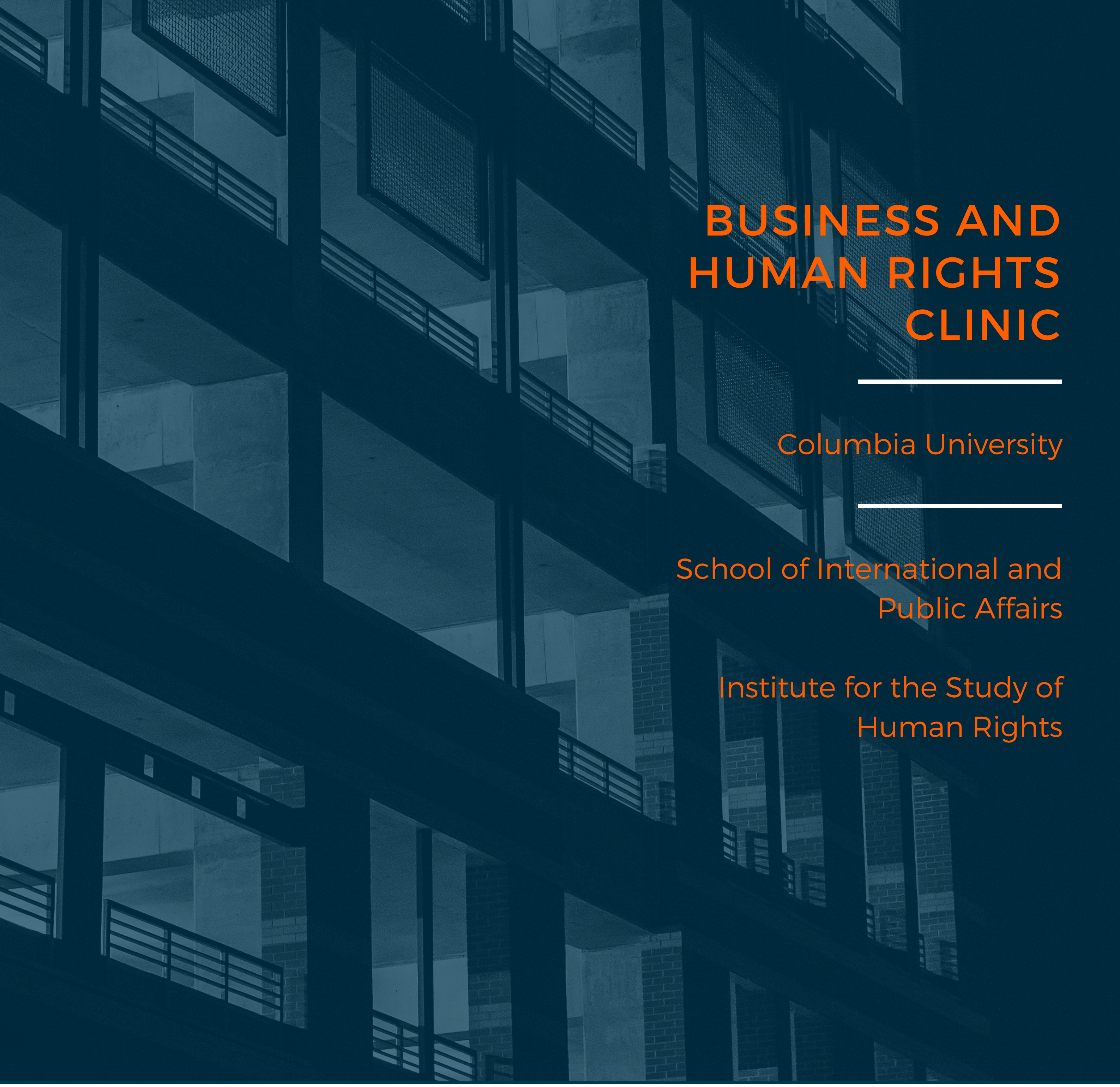

BUSINESS AND HUMAN RIGHTS CLINIC

Columbia University

School of International and Public Affairs

Institute for the Study of Human Rights

2018

PENSION FUNDS AND HUMAN RIGHTS

A STUDY OF THE HUMAN RIGHTS CONSIDERATIONS OF PENSION FUNDS

Pension Funds and Human Rights:

A study of human rights considerations of pension funds

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About the Business and Human Rights Clinic

The Business and Human Rights Clinic is a year-long course at the School of International and Public Affairs, Columbia University, designed to deepen student knowledge and experience of business and human rights through practice. Combining seminars, guest lectures, group work, and site visits, the Clinic is an interdisciplinary space for testing new business and human rights methods and tools, carried out in partnership with non-governmental organizations (NGOs) and other practitioners. From 2015-2017, the Clinic worked with Inclusive Development International to pioneer investment chain mapping, a methodology that puts valuable information about the upstream, midstream, and downstream investors of harmful projects into the hands of affected communities who are fighting to defend their rights.

This report represents research, carried out by the 2016-2017 Clinic, builds on that effort by examining the human rights calculus of one financial actor: pension funds. The Clinic team consisted of: Meagan Barrera, Lucia Diaz-Martin, Chase McNabb, Helga Steinarsdottir, Ally Tang, Madeline Wolberg, and Yiruo Zhang. Madeline Wolberg is the report editor. Joanne Bauer, Adjunct Professor of International Affairs and Clinic Faculty Lead, oversaw the research and report writing.

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Acknowledgments

Our research was spurred by questions about the human rights due diligence practices of financial actors that arose in our mapping of investment chains of harmful development projects. We conducted the mapping work for our client, Inclusive Development International (IDI), in support of their Follow the Money initiative. Follow the Money "illuminates the path to justice by uncovering and exposing those who profit from harmful investments. By systematically shining a light on the backers of these projects, mapping investment chains and relevant pressure points, and providing tailored advice about potential advocacy strategies to affected communities, Follow the Money can put valuable information into the hands of affected communities to enable them to protect their rights.[1] We are grateful for the guidance of IDI's Natalie Bugalski, David Pred, and Dustin Roasa in carrying out this research.

Conversations with experts in responsible investment in March and April 2017 helped to inform our research questions, including: Larry Beeferman, Project Director, Pensions & Capital Stewardship Project at Harvard Law School; Lara Blecher, Shareholder Engagement Executive at Pensions and Investments Research Consultants (PIRC); Ryan Brightwell, Researcher at Bank Track; Vonda Brunsting, Director of the Capital Stewardship Program at the Service Employees International Union (SEIU); Michelle Chan, Vice President of Programs at Friends of the Earth International; Jeff Conant, Senior International Forests Program Manager at Friends of the Earth International; Rachel Davis, Managing Director at Shift; Peter Drury, Human Rights Researcher and Campaigner at Global Witness; Kate Geary, Forest Campaign Manager at Bank Information Center; Rob Lake, Independent Responsible Investment Advisor at Rob Lake Advisors; Will Martindale, Head of Policy at the UN Principles for Responsible Investment; Bettina Reinboth, Manager, Social Engagements at the UN Principles for Responsible Investment; and Delilah Rothenberg, Managing Director, Development Capital Strategies at Pegasus Capital Advisors. The Clinic is indebted to these individuals for their time and constructive feedback.

We are also grateful to the pension fund managers who we interviewed for this study. They agreed to speak to us with the understanding that they would not be named in the report; an additional pension fund manager spoke to us on the condition that the name of their fund remain confidential.

[1] Inclusive Development International, "Follow the Money Initiative," https://www.inclusivedevelopment.net/what/follow-the-money-initiative/. (accessed March 27, 2018)

Executive Summary

In recent years the role of financial actors in contributing to and preventing corporate harms to workers, communities, and other stakeholders has come under scrutiny. Yet, to outsiders, how human rights figures into investment decisions remains obscure, as are the processes behind complex investments. Without a deep knowledge of the investment process, it is difficult for human rights advocates to effectively engage with investors, put pressure on them to improve or divest from projects with negative human rights impacts, and help them proactively identify human rights risks. Focusing primarily on pension funds and their infrastructure investments, this research aims to illuminate the extent to which fund managers integrate human rights considerations into their investment decisions. It is intended as a starting point for human rights advocates who seek to engage more effectively and constructively with pension fund managers and strengthen responsible investment practices.

For this research we contacted twenty pension funds and asset managers; among the twenty, eleven managers at eleven funds in eight countries, including an oversight body, agreed to an interview. Those funds are: Algemene Pensioen Groep (APG), Arbejdsmarkedets Tillægspension (ATP), the Australian Superannuation Fund, the Council of Ethics for the Norwegian Pension Fund, Government Employees Pension Fund (GEPF), Kommunal Landspensjonskasse (KLP), the New Zealand Superannuation Fund, the Ontario Teachers' Pension Plan (OTPP), and Stichting Pensioenfonds voor de Gezondheid, Geestelijke en Maatschappelijke Belangen (PGGM). Our points of contact for each pension fund were individuals situated in responsible investment or "ESG" (economic, social, and governance) functions. Prior to each interview, we conducted a desk review of each pension fund to identify gaps in publicly available information and tailored the interview protocol for each interviewee to fill these gaps.[2]

Key findings:

- Responsible investment functions of pension funds typically have some knowledge about international human rights standards; yet, this knowledge is not mainstreamed throughout the organization.
- There remain gaps in existing risk assessment and monitoring procedures within institutions, and industry-wide best practices are only beginning to emerge.
- Responsible investment teams are often challenged by insufficient capacity and would benefit from an expanded team that is knowledgeable about human rights risks and are able to conduct in-depth monitoring and assessment of the human rights implications of fund investments.
- Pension funds usually engage with investee companies when there are major or systematic human rights concerns, as opposed to isolated incidents, and will consider divestment only

[2] See the Annex for further details about the research process.

when investee companies refuse to engage.

- Investment managers recognize that good information is a key challenge, and many are open to improved communication channels with NGOs.

A note about our research sample:

Our study should be interpreted in the context of the research sample, which was shaped by a focus on pension fund investments in infrastructure. Three characteristics of the sample are important to note.

First, the funds we studied were mostly large pension funds, and it is likely that the alertness to human rights of the fund representatives we spoke with is greater than one would find at smaller pension funds. Therefore, the applicability of the characterizations found within this report cannot necessarily be extended to smaller funds.

Second, as noted above, our interviewees were mostly situated in the ESG function of the fund. These individuals are often removed from those making investment decisions. During our interviews we sought to understand the extent to which the ESG function has an influence on investment decisions, and this is reflected in the findings reported here. Access to more asset managers, which we were unable to obtain, would have provided a more accurate picture of the full extent to which human rights are considered in the investment calculus.[3]

Third, European pension funds, which are over-represented in our sample,[4] are being pressured through the recommendations of the European Union's High-Level Expert Group on Sustainable Finance to make long-term investments and to poll their beneficiaries on their preferences for environmental and social factors. In contrast, the outlook of U.S. pension funds in practice remains short-term.[5]

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[3] While we cannot say with any certainty why we were unable to gain access to asset managers, even though the ESG managers, may be that it is an indication of a weakness in the structure of the fund, whereby human rights commitments are not adequately integrated throughout the fund, reflecting shortcomings in communication and training. In their 2015 pension funds study, Beeferman and Wain point to these apparent gaps. See Larry Beeferman and Allan Wain, *Infrastructure: Doing What Matters*, Working Paper, February 2015, pp 134-137, http://ssrn.com/abstract=2714343. (accessed March 27, 2018)

[4] The countries are: Australia, Canada, Denmark, the Netherlands, New Zealand, Norway, South Africa, and the United States.

[5] The Employee Retirement Income Security Act of 1974 (ERISA), applicable to private pension funds and influential for public pension funds, requires that fiduciaries' decisions be made in the "sole interest" of plan participants and beneficiaries and for the "exclusive purpose of…providing benefits" to them. (Section 1004(a)(1)). One hotly contested question is whether pension plan assets may be used to foster other purposes. The answer to that question—cast in the form of interpretive regulations by the U.S. Department of Labor—has shifted with changes in administrations. Generally, such investments are discouraged unless they can be proven equal in risk-return profile to alternatives. The most recent formulation—under the Obama administration—at minimum approved of and arguably encouraged taking account of ESG considerations in such terms, which is seen by some as embracing a commitment to "long term" investing. Yet in practice this interpretation conflicts with pressures and incentives—underfunded pensions, how pension fund asset managers are compensated, etc.—which spur short-term investing.

I. Introduction

In February 2017, more than 120 institutional investors and other organizations, including at least eight public and private pension funds from the U.S. and Canada, signed an investor statement to seventeen commercial banks that had loaned money to the controversial Dakota Access Pipeline (DAPL) project. These investors, representing a total of $653 billion in assets under management, called upon the banks to intervene on behalf of the Standing Rock Sioux Tribe in North Dakota and to "address or support" their request to reroute the pipeline away from sacred lands and a critical water source. As shareholders of these banks, the investors wrote, "We are very concerned by the reputational and potential financial risks due to these banks being associated with DAPL."[6]

In March 2017, Kommunal Landspensjonskasse (KLP), a Norwegian municipal pension fund manager, publicly announced its divestment from four companies directly involved in constructing and benefiting from the DAPL: Energy Transfer Partners, Phillips 66, Enbridge Energy Partners, and Marathon Petroleum. The fund distributed a fourteen-page document to its clients and the public outlining the reasons behind its choice to divest. Crucial among them was KLP's determination that the project posed "an unacceptable risk of contributing to serious or systematic human rights violations" based on international human rights standards such as the UN Declaration on the Rights of Indigenous Peoples (UNDRIP) and the UN Guiding Principles on Business and Human Rights (UNGPs).[7]

The DAPL incident was a canary in the coal mine for many investors. The public controversy around the role of investors in financing the project led to bank boycotts and negative international press attention focused on the investors. The reaction reflects a shift that has been underway for several years, wherein commercial lenders and equity investors are increasingly called to account for the human rights impacts of the projects that they profit from.[8] Interpreting the UNGPs, which emphasize that "the responsibility to respect human rights applies fully and

[6] "Investor Statement to Banks Financing the Dakota Access Pipeline," February 16, 2017, http://news.bostoncommonasset.com/wp-content/uploads/2017/02/Investor-Statement-to-Banks-Financing-the-Dakota-Access-Pipeline-FINAL-with-signatories-2-17-17.pdf. (accessed March 22, 2018)

[7] KLP, *Decision to Exclude Energy Transfer Partners, Phillips 66, Enbridge Inc., and Marathon Petroleum Corporation*, March 2017, http://english.klp.no/polopoly_fs/1.35747.1489391754!/menu/standard/file/Decision%20to%20exclude%20ETP%20Phillips%2066%20Enbridge%20and%20Marathon%20Petroleum.pdf. (accessed March 22, 2018)

[8] It should be noted that lenders and shareholders have different legal responsibilities and options. A loan will have a specified term and specified ways that the loan contract can be violated, such as taking on additional debt. If the contract is not violated, lenders have no voice in the operations of the company over the term of the loan. The only way for a lender to monitor a borrower for human rights abuses is for a specific covenant to be written into the loan contract at the time the loan is made. An example of such a loan is a sustainability loan, such as the syndicated loan made to Danone in 2017, whereby the cost of capital declines as sustainability measures improve. See: https://www.forbes.com/sites/jaycoengilbert/2018/02/20/every-cfo-should-know-this-the-future-of-banking-ties-verified-esg-performance-to-cheaper-capital/#7e7bf26d7e4d. Or, if a loan is coming up for renewal, lenders might threaten the borrower with more onerous terms or even non-participation the next time it seeks financing. By contrast, shareholders have a continuous ability to monitor the companies whose shares they own.

equally to all business enterprises,"[9] the OECD *Report on Responsible Conduct for Institutional Investors* makes explicit the connection between investors and harm:

> Investors, even those with minority shareholdings, may be directly linked to adverse impacts caused or contributed to by investee companies as a result of their ownership in, or management of, shares in the company causing or contributing to certain social or environmental impacts.[10]

Investors therefore have a responsibility to "use their so-called 'leverage' with companies they invest in to influence those investee companies to prevent or mitigate adverse impacts."[11] In comparison to other financial actors, pension funds increasingly have directly or indirectly acknowledged this responsibility, with strong representation among signatories to the DAPL investor letter and participating in responsible investment initiatives, such as the UN Principles for Responsible Investment (UNPRI).

Some financial actors have resisted this assignment of responsibility, however. The Thun Group of Banks, an informal network of eleven leading commercial banks convened to interpret and apply the UNGPs for lenders, released a statement in January 2017 claiming that "a bank's financial products or services are not linked to human rights impacts caused or contributed to by one of the client's entities." The report asserts that as banks, they are therefore not responsible for providing remedy when an abuse occurs in their investment chain, a claim John Ruggie, author of the UNGPs, has disputed.[12] Nevertheless, civil society, backed by the Office of the High Commissioner for Human Rights (OHCHR) and the OECD Working Party on Responsible Investment, have increasingly drawn investors into the conversation about human rights impacts in their investments, calling on them to exercise their leverage to influence investee companies, or divest. As the norms surrounding the responsibility of institutional investors develop,[13] investors can no longer hide behind minority ownership status, a narrow definition of their fiduciary duty to their clients, or their distance (both geographic and in the investment chain) from problems

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[9] United Nations, *Guiding Principles on Business and Human Rights: Implementing the United Nations "Protect, Respect and Remedy" Framework*, 2011, p. 13, http://www.ohchr.org/Documents/Publications/GuidingPrinciplesBusinessHR_EN.pdf. (accessed March 22, 2018)

[10] Organisation for Economic Cooperation and Development (OECD), *OECD Guidelines on Responsible Business Conduct for Institutional Investors*, 2017, p. 13, https://www.oecd.org/finance/RBC-for-Institutional-Investors.pdf. (accessed March 22, 2018)

[11] Ibid.

[12] Thun Group, *Discussion Paper on the Implications of UN Guiding Principles 13 & 17 in a Corporate and Investment Banking Context*, 2017, p. 14, https://business-humanrights.org/sites/default/files/documents/2017_01_Thun%20Group%20discussion%20paper.pdf. (accessed March 22, 2018)

[13] See, for example, the recently released *OHCHR response to request from BankTrack for advice regarding the application of the UN Guiding Principles on Business and Human Rights in the context of the banking sector*, which lays out the scope of banks' responsibility to respect human rights: http://www.ohchr.org/Documents/Issues/Business/InterpretationGuidingPrinciples.pdf. (accessed March 22, 2018)

occurring on the ground. Beyond DAPL, investors throughout the entire investment chain are in the spotlight for their investments in controversial projects in the West Bank, Western Sahara, Sierra Leone, Vietnam, Indonesia, Colombia, Honduras, Australia, and countless other places.

In this moment of increasing expectations for investor responsibility, pension funds have an important role to play given the sheer size of the assets that they control. In 2014, public pension fund reserves for retirement plans held USD 30.2 trillion in capital funds amounting to 61.9 percent of OECD countries' GDP.[14] In 2015, private pension assets reached more than $38 trillion worldwide. According to the OECD's annual report on pension fund trends, "Assets invested through all pension vehicles in financial markets reached $36.9 trillion in the 35 OECD countries in 2015, and amounted to $1.3 trillion in a sample of 45 non-OECD countries."[15] Further, pension funds were the primary investors of these assets, investing 68 percent of the total amount themselves ahead of banks and investment companies (20.2 percent), insurance companies (11.3 percent), and employers through their book reserves (0.5 percent).[16]

The scale of international financial capital currently under pension fund management makes understanding the human rights considerations in investment decisions particularly important for human rights advocates. Even as they become increasingly adept at identifying pension fund investments in harmful projects, human rights advocates often do not know the right channels through which to convey the facts of harmful impacts to those fund managers, or how to convince them to address the harm or threat of harm.

This research seeks to shed light on how human rights considerations figure into the investment calculus of pension funds in order to guide human rights advocates to more effectively target their advocacy efforts. How do fund managers—both in-house pension fund investment managers and outsourced external fund managers—scope and identify human rights impacts? How are these impacts valued when deciding whether to invest, engage, or divest from a company? What are the challenges to adequately accounting for human rights considerations, and how can these challenges be addressed? How do pension funds respond when they learn of human rights violations in their portfolios? How well are human rights standards understood within the firm, in particular by those responsible for the deals? We also aim to identify areas for future research and opportunities for collaboration between advocates and pension funds.

In the following sections, we describe the characteristics of pension funds that make them a compelling focus for a study of human rights considerations in investment decisions (section II); detail the findings of our research and highlights key themes and trends (section III); and present recommendations for human rights advocates, investors, and researchers (section IV).

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[14] OECD, *Annual Survey of Large Pension Funds and Public Pension Reserve Funds*, 2015, p. 10, http://www.oecd.org/daf/fin/private-pensions/2015-Large-Pension-Funds-Survey.pdf. (accessed March 22, 2018)

[15] OECD, *Global Pension Statistics*, 2017, p. 5, http://www.oecd.org/finance/financial-markets/globalpensionstatistics.htm. (accessed March 22, 2018)

[16] Ibid.

II. Why Pension Funds?

Pension funds occupy a unique and growing position in the global investment arena. As they become increasingly active in emerging markets, their potential and actual impacts on vulnerable communities give ample cause for critical examination of how human rights are factored into investment decisions. Certain characteristics of pension funds, including the local legal and political context in which they operate, render them potential allies in the advancement of human rights, and potential leaders in responsible investment.

There are several reasons why pension funds make a compelling focus of a study of human rights considerations of financial actors: pension funds typically represent long-term investments; in certain countries, are subject to strict government regulation and public scrutiny; and are increasingly holding high risk investments, such as in mega infrastructure projects.

1. Long-term investment strategy

As holders and investors of workers' retirement savings, pension funds are under pressure to develop long-term investment strategies. This pressure, together with the tendency of pension funds to invest across the global market as "universal investors" makes them particularly sensitive to human rights risks, including company-community conflicts, that could result in an investee company's loss of social license to operate, or otherwise negatively impact an investment's value.[17] Furthermore, like other investors, pension funds are subject to legally mandated fiduciary obligations to generate returns for their beneficiaries, which may encourage a more conservative approach to investment that seeks stability and longevity above all else. Despite the traditional mandate to invest in stable, long-term assets, a 2016 OECD report highlights a decade-long trend in some OECD countries to loosen regulatory restrictions on pension funds, thus giving more discretion to pension funds than before.[18] Likewise, the World Bank has pushed for pension fund regulatory reform, asserting that restrictions like quantitative caps or limits on foreign investment can hinder fund performance.[19]

2. Subject to additional public and government scrutiny

The governance structure of the pension fund, which informs the fund's investment

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[17] Rachel Davis and Daniel Franks, *Costs of Company-Community Conflict in the Extractive Sector*, Harvard Kennedy School, Corporate Social Justice Initiative, 2014, https://www.hks.harvard.edu/m-rcbg/CSRI/research/Costs%20of%20Conflict_Davis%20%20Franks.pdf (accessed March 22, 2018) and Virginia Barreiro, Mohiburrahman Iqbal, Godwin Limberg, Rauf Prasodjo, Aisyah Sileuw and Jim Schweithelm, *The Cost of Conflict in Oil Palm in Indonesia*, November 2016, http://daemeter.org/new/uploads/20170121193336.The_Cost_of_Conflict_in_Oil_Palm_Indonesia_.pdf. (accessed March 22, 2018)

[18] OECD, *Annual Survey of Investment Regulation of Pension Funds*, 2016, p. 6, www.oecd.org/daf/fin/private-pensions/2016-Survey-Investment-Regulation-Pension-Funds.pdf. (accessed March 22, 2018)

[19] World Bank, "Portfolio Limits," *World Bank Pension Reform Primer*, http://siteresources.worldbank.org/INTPENSIONS/Resources/395443-1121194657824/PRPNotePortLimits.pdf. (accessed March 22, 2018)

objectives and approaches, as well as fiduciary duty, are determined by statutes, by-laws, contracts, or trust instruments, which are typically guided by laws and regulations.[20] Pension funds may be *public* or *private*. A public pension plan is a "statutory program" administered by the government.[21] Private pension plans can be administered by an employer, a private pension fund, or another private sector pension provider.[22] Both public and private funds are typically subject to national or sub-national legislation regulating their investment practices, and thus their policies and procedures can vary across jurisdictions. Public pension funds are generally subject to more stringent rules regarding the types of assets and geographic regions that they can invest in. For example, pension funds in Denmark are not permitted to invest in companies or countries at odds with any treaties the government has ratified, including human rights treaties, and sanctions established by multilateral organizations that Denmark is a member of.[23] The European Parliament's 2016 law requires all pension funds in the EU to take into account "environmental, social and governance risks" when making investment decisions, including climate change risks.[24]

The importance of pension fund assets to some economies is another reason why their investments may be closely scrutinized. The 2016 OECD report on pension fund trends indicates that, though the size of investments through pension funds varies by country, private pension fund assets in some countries dwarf the domestic economy. For example, private pension fund assets are 205.9 percent larger than the GDP of Denmark; 178.4 percent larger than the GDP of the Netherlands; 156.9 percent larger than the GDP of Canada; and 95.8 percent larger than the GDP of South Africa.[25]

3. Increasing focus on infrastructure investment and higher-risk investments

Given the trend towards loosening pension fund investment rules, pension fund supervisory authorities have moved towards a risk-based approach to investment, in which the most critical financial risks are identified and weighed against the fund's financial vulnerability to adverse experiences. Compared to rules-based regulation, risk-based regulation enables pension funds to take on a wider range of investments.[26] Simultaneously, the role of pension funds as influential

[20] OECD, *OECD Guidelines for Pension Fund Governance*, 2009, p. 5, http://www.oecd.org/daf/fin/private-pensions/34799965.pdf. (accessed March 22, 2018)
[21] OECD, "Public Pension Plans," *OECD Glossary of Statistical Terms*, 2005, stats.oecd.org/glossary/detail.asp?ID=5286. (accessed March 22, 2018)
[22] OECD, "Private Pension Plans," *OECD Glossary of Statistical Terms*, 2005, stats.oecd.org/glossary/detail.asp?ID=5283. (accessed March 22, 2018)
[23] Laegernes Pension, *Responsible Investment Report 2012*, Principles for Responsible Investment, February 2013, https://www.lpb.dk/media/394a0b52-ea95-492b-a471-18f806fa13df/j8mGyQ/Dokumenter/Pension%20og%20forsikring/Investering/PRI-besvarelser/PRI-besvarelser%20for%202011.pdf. (accessed March 22, 2018)
[24] Francesco Guarascio, "EU requires pension funds to assess climate change risks," *Reuters*, November 24, 2016. http://www.reuters.com/article/us-eu-finance-climatechange-idUSKBN13J1SV. (accessed March 22, 2018)
[25] OECD, *Pension Funds in Focus*, 2016, Fig. 3, p. 10, http://www.oecd.org/daf/fin/private-pensions/Pension-Markets-in-Focus-2016.pdf. (accessed March 22, 2018)
[26] Fiona Stewart, "Pension Funds' Risk-Management Framework: Regulation and Supervisory Oversight," *OECD*

players in financial markets has steadily grown in recent years. The OECD's 2015 annual survey of pension funds highlights that retirement systems hold greater savings than ever before, underscoring "the important role that [pension fund] institutions can play as sources of productive long-term capital."[27]

As a result, pension funds are increasingly moving into higher-risk investments both domestically and abroad, particularly investment in large-scale infrastructure projects. Among the action areas identified in the Addis Ababa Action Agenda—a UN agenda to facilitate financing for sustainable development—is the need to increase private investment in infrastructure projects in developing countries. Pension funds and other capital-strong, long-term institutional investors are relied upon to allocate a greater share of their portfolios to projects of this type.[28] Currently, there is a growing interest in infrastructure investment among pension fund asset managers, although levels of investment in that asset class are still relatively low. Moreover, asset managers remain largely focused on developed country markets, but appear willing to exploit immediate opportunities in emerging markets.[29] Political instability and volatile markets are still a barrier to their investment in developing markets, but development finance institutions, such as the International Finance Corporation (IFC), are poised to mitigate such risks. There is also political pressure on pension funds to invest in infrastructure at home, and governments increasingly look to institutional investors like pension funds for contributions to the rebuilding and development of their economies in general, echoing international commitments.[30] This evolution raises multiple issues for pension funds that prioritize a responsible investment approach, as infrastructure projects carry high risks of adverse human rights impacts; they may also be carried out in environmentally sensitive areas where communities are socially vulnerable, e.g. due to poverty, seclusion, or their indigenous status.[31]

Given these risks, pension funds face increasing pressures to integrate a responsible approach into their investment processes. In some respects, these pressures are no different from what other types of investors are experiencing. However, bolstered by a growing body of research positing that sustainable investments may in the long-run match or even outperform traditional investment plans, they are particularly relevant to the long-term horizon of pension funds. Coupled

Working Papers on Insurance and Private Pensions, No. 40., 2010, p. 2, www.oecd.org/finance/private-pensions/44633539.pdf. (accessed March 22, 2018)

[27] *OHCHR response to request from BankTrack for advice regarding the application of the UN Guiding Principles on Business and Human Rights in the context of the banking sector* 10.

[28] United Nations, "Addis Ababa Action Agenda," *Financing for Development.* 2015, p. 24, www.un.org/esa/ffd/wp-content/uploads/2015/08/AAAA_Outcome.pdf. (accessed March 29, 2018)

[29] *OHCHR response to request from BankTrack for advice regarding the application of the UN Guiding Principles on Business and Human Rights in the context of the banking* pp 19-20

[30] "Third More Pension Funds Invest in Infrastructure," *Financial Times.* February 7, 2016. www.ft.com/content/b6744ff8-cc29-11e5-a8ef-ea66e967dd44. (accessed March 29, 2018)

[31] *The Future Development Finance and Accountability Landscape: Workshop Summary and Outcomes.* Institute for the Study of Human Rights, Columbia University, 2016, p. 3, www.humanrightscolumbia.org/sites/default/files/pdf/bhr_future_development_finance_accountability_landscape.pdf. (accessed March 29, 2018)

with pension funds' increasingly international and diversified portfolio, this long-term approach depends in many ways on the health and continuity of the global investment universe.[32] A great number of pension funds have implemented progressive ESG and human rights policies and contributed to standard-setting in sustainable investment. The task remains, nonetheless, to adopt and develop those policies to adequately meet the challenges to responsible investment brought about by a wider range of investments and expansion into developing markets.

III. Findings

Our research reveals that responsible investors are generally aware of human rights and are working to integrate them into investment practices, though pension fund managers struggle to implement policies and procedures to consistently predict, detect, and resolve human rights issues. Further, some pension funds have made greater strides than others in addressing human rights impacts, and even the most advanced funds struggle to systematize and mainstream their risk assessment procedures and other practices. A further complication for pension funds is that they often do not select their own investments, but rather they outsource these decisions to an external investment manager.[33] Below the key findings of our conversations with responsible investment managers are presented, along with supporting desk research into each pension fund's overall investment strategy, responsible investment policies and procedures, history of stakeholder engagement, and shareholder voting.

A. Risk Assessment and Monitoring

Where human rights risks are high, effective risk assessment and monitoring of investment impacts are crucial to preventing human rights violations, particularly in large-scale, long-term investments such as energy, natural resource extraction, or infrastructure. The UNGPs require companies to perform human rights due diligence to "identify, prevent, mitigate and account for … their adverse human rights impacts," and demand that it be "ongoing, recognizing that the human rights risks may change over time as the business enterprise's operations and operating context evolve."[34] Our research into pension funds' policies for continuous monitoring and assessment of investments reveals gaps in monitoring processes and highlight areas for human rights advocates and investors to collaborate in bridging these gaps.

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[32] Mirjam Staub-Bisang, "Public Pension Funds: Sustainable Investment Pioneers," *The Guardian*, August 8, 2013, www.theguardian.com/sustainable-business/public-pension-funds-sustainable-investment-pioneers. (accessed March, 29, 2018)

[33] In Europe, it is common for pension funds to use external investment managers (only the largest funds have large teams and make their decisions in-house), whereas in the United States pension funds are increasingly managing their own investments. See: Charles McGrath, "Public Plans Managing In-House," Pensions & Investments, October 13, 2017.

[34] UN Guiding Principles, Guiding Principle 17.

Managers focus on the reputational and financial risks posed by human rights harms occurring in their portfolio

The concept of human rights risk assessment can be viewed through two distinct lenses: "materiality," or the risk to the investor; and "salience," or the risk to stakeholders, including affected communities, workers, and consumers. A key challenge when assessing materiality is accounting for human rights risks that are not easily quantifiable or that are perceived by investors to fall within an acceptable level of financial risk. Hence, human rights risks are seen by some managers as too subjective to be reliably assessed, and questions over what types and sources of data (for example, from the investee company, a large NGO, or directly from affected communities) should be considered when weighing these risks.[35]

Measuring salience may be more straight forward. According to the UN Guiding Principles Reporting Framework, "salience" refers to those human rights that "stand out because they are at risk of the most severe negative impact through the company's activities or business relationships." The concept of salience uses the "lens of risk to people, not the business, as the starting point, while recognizing that where risks to people's human rights are greatest, there is strong convergence with risk to the business."[36]

Consider an investment manager for a pension fund deciding whether to invest in a palm oil company with a history of allegations of forced eviction and displacement. Human rights advocates are likely to be concerned with risks to people: physical and cultural displacement may result in loss of economic livelihood and of means of subsistence, and may entail violence by the state, for example. By contrast, investment managers may understand these same issues in terms of financial impact: Will social unrest caused by displacement negatively impact the viability and stability of this investment? While the answers may be linked—financial outcomes could be affected by social outcomes—each question represents a different investment calculus that weighs human rights considerations according to distinct criteria.

The distinction between materiality and salience emerged as a central theme of our interviews, as interviewees told us they grapple with striking a balance to make investments that are both responsible and profitable. They see little conflict between the two objectives, and generally support the view that the mitigation of human rights risks is integral to the performance of an investment—in other words, that human rights are material. Yet financial performance is not the only factor guiding their investment decisions. Citing the UNGPs and the OECD Guidelines for Multinational Enterprises (OECD Guidelines), one manager explicitly stated that her fund's policies on human rights risk are guided by international standards that "focus on the people at risk, not the financial risk." Another interviewee summed up the challenge of ensuring that

[35] Mozaffar N. Khan, George Serafeim, and Aaron Yoon, "Corporate Sustainability: First Evidence on Materiality," *Harvard Business School Working Paper*, No. 15-073, March 2015, http://hbswk.hbs.edu/item/corporate-sustainability-first-evidence-on-materiality. (accessed March 22, 2018)
[36] Shift Project and Mazars, *UN Guiding Principles Reporting Framework*, http://www.ungpreporting.org/key. (accessed March 22, 2018)

investments are profitable and avoid human rights risks in the following way:

> On the one hand, if you think of an active portfolio manager, everything that's material they should be looking at; human rights or whatever blind spot needs to be addressed. On the other hand, I would not want to see such a version when we prioritize human rights cases on the basis of materiality. We base our priority on the severity of impact, and it doesn't matter whether our holding is half a billion in the company or if it's two billion. It's about the severity of the impact.

This interviewee pointed out that it is often difficult to separate financial risk and human rights risk, saying, "The presence of human rights risks can preclude financial gains in some cases." Another interviewee described the relevant considerations for materiality using the example of a hypothetical investment:

> If you invest in infrastructure and roads [...] what kind of ESG issues are typical for that? What can you expect as an impact? So then [our investment analysts] look at it and [use] all the material issues in their evaluations. For example, they take into consideration if there is something that has to be remedied [...] or if there was any litigation or if there is some impact on health and safety, which has to be improved, they take all this sort of cost and impact into consideration into the valuation of the company [to be invested in].

Unsurprisingly, all the managers cited reputational risk as an important factor when determining whether to address human rights violations in current or potential investments. One manager said that her organization "define[s] responsible investment as the balance between expected return and all material risks, including ESG and reputational issues." She also noted:

> We are very protective of our brand and reputation as solid investors, investors that people want to have as part of their companies. Anything that would impinge on our reputation would be considered risk.

Investment managers seek to quantify human rights risks or otherwise standardize their assessment and monitoring processes.

That pension fund managers endeavor to quantify or otherwise standardize non-financial risks is understandable considering the vast amounts of information that both traditional and responsible fund managers must analyze to determine whether an investment is sound. All of the interviewees cited a diversity of tools for assessing human rights and other non-financial risks, including frameworks developed by civil society or multi-stakeholder initiatives, voluntary standards, and materiality maps[37] developed by groups like the Sustainability Accounting

[37] A map that presents a breakdown of material disclosures—topics that impact stakeholders and shareholders—often by sector and industries.

Standards Board (SASB) and Morgan Stanley Capital International (MSCI). Some pension funds have developed their own financial and ESG risk assessment frameworks, which can be fine-tuned to account for differences between asset classes and geographies. One pension fund we researched has developed nearly forty different "industry frameworks" that guide responsible investment practices across a diversity of sectors. Another pension fund accounts for risks across asset classes by maintaining ESG frameworks for each investment category that show "which ESG factors affect the financial performance of underlying investments and to what extent." The portfolio managers at one pension fund use an algorithm to statistically identify high-risk investments according to geographic and sectoral risks factors that should be monitored or excluded when making investment decisions.

Despite a proliferation of responsible investment frameworks, a common concern expressed by the managers we interviewed is the lack of data on the financial implications of human rights violations. One respondent suggested that reports on human rights risks and impacts would be more helpful if it were possible to establish direct links between the issues discussed in those reports and financial impacts on investee companies. Similarly, another raised the issue that her organization has set specific targets and measurable quantifiable indicators by which to assess all investments, but that, in her view, human rights are not quantifiable. Information that facilitates a better understanding of "the quantifiable or tangible nature" of the human rights risks allows the environmental and social risk management (ESRM) teams to make the case to investment managers that human rights concerns need to be elevated in investment decisions. Attempts at standardizing monitoring and assessment procedures notwithstanding, several of the pension fund managers expressed the sentiment that materiality assessment "comes down to a judgement call," meaning that the priorities and knowledge of individual investment managers or investment teams will have a heavy influence on how human rights risks and impacts are weighed.

Reliance on external asset managers poses unique challenges when it comes to human rights monitoring and assessment.

An additional obstacle to mainstreaming human rights considerations in pension fund investing arises in the relationship between funds and their external asset managers. Even where funds have formal policies and investment rules to guide the decisions of these managers, funds may not have a reliable mechanism to ensure compliance. Many of the interviewees reported that their fund's asset managers rely upon ESG ratings compiled by external research firms. Asked about factors affecting their organization's choice of external asset managers, all pension funds indicated that human rights and responsible investment considerations are taken into account when contracting with external managers, although it was not clear how significantly. The pension funds employ a variety of mechanisms to establish ESG expectations for external asset managers and to monitor implementation. These include specific policies and investment rules that external managers are required to adhere to, surveys of contracted management firms, and periodic reviews.

At the time of our interviews, only one of the pension funds we researched had conducted formal trainings for investment managers on understanding and accounting for human rights risks and impacts in investment decision-making. According to their websites, all of the pension funds maintain executive-level oversight of their ESG policies and procedures via formal advisory boards, steering committees, or the board of directors. The interviewees indicated that there was some understanding of human rights throughout their organizations, though nearly all also said that human rights impacts were not always well-understood by portfolio managers outside of the ESRM function, and that understanding in general tended to vary by department, role, and asset class. One interviewee said that, in her experience, different societal perspectives influenced whether or not investors and clients viewed issues, such as access to water, as a human right. Another interviewee pointed out that different legal frameworks across different countries influence whether an issue, such as land rights, is considered to be a human right, and that there may be gaps between the domestic legal responsibility of the investee company and international human rights norms; this can complicate matters for the pension fund when engaging with investee companies that do not acknowledge human rights violations as such.

Some of the fund managers highlighted the challenges of monitoring investments managed outside their firms, especially for investment vehicles such as pooled funds that contain many securities. One interviewee noted that his firm sometimes does not learn about human rights impacts in its externally managed pooled funds until after an issue arises, at which point it can be difficult to exit the fund. He also pointed out that "the more illiquid the assets and the harder they are to sell, the harder it is to deal with human rights concerns." Another interviewee said that it can be challenging to maintain formal oversight policies for externally managed assets because different asset classes have different types of risks. As a result, her organization tends to handle problems on an ad hoc basis rather than developing separate policies to address different types of risks in externally managed assets.

Ongoing monitoring of investments can be more feasible than risk assessment prior to investing.

For pension funds that invest directly in infrastructure and other large-scale projects, there is an added layer of complexity to tracking human rights risks and impacts over time: investors typically lack awareness of the situation on the ground and may struggle to obtain this information until after negative human rights impacts receive media attention or are brought to their attention by NGOs. Pension fund investment managers may be unfamiliar with the technical aspects of a project and the risks that different phases of a long-term investment, particularly a thirty-year infrastructure project, can pose. For investments in publicly-listed companies or pooled funds, ongoing monitoring is complicated by the number of companies in a portfolio, often causing them to overlook new human rights risks that may not have been present during the pre-investment risk assessment process. In these cases, advocates or journalists often draw connections between investors and harmful projects before the fund manager is aware of the issue.

Several of the interviewees noted that ongoing monitoring of human rights impacts of projects in their investment portfolios is “really underdeveloped” among investors in general and that it has “been a journey” to develop the internal procedures. Only three of the pension funds have clearly elaborated processes for monitoring the impacts of ongoing investments over time, and among these funds the responsible investment function was working to mainstream these practices throughout the investment team. For the majority of funds that we studied, however, only the ESRM team is responsible for monitoring investments, which limits the fund’s capacity to perform continual monitoring on all investments. About a quarter of the interviewees stated that they try to regularly conduct human rights risk analyses of all of their investments, though at least one of the pension funds achieves this via computerized algorithms and statistical probability of geographic and sectoral risks, rather than oversight of each investment. Two of the interviewees stated that their organization conduct occasional site visits, though they declined to say how investments are selected for site visits.

Engagement is preferable to divestment because it provides an opportunity to exert influence and have a greater impact.

Every one of the pension funds’ websites had a section describing the organization’s policy on investee engagement. This suggests that pension funds consider engagement an important tool to address problems that arise in investments. Most of the managers we interviewed stated that they would rarely divest from a company unless there was a particularly egregious offense, framing the choice to engage as an opportunity to exert influence over investee companies, while divestment would have limited impact on the company’s behavior. One manager said that the decision to divest is often a “political discussion,” so pension funds often “focus [first] on engagement and then [on] improving the situation.” Another expressed concern over divestment because exiting the company would mean that their “shares would just be gobbled up by other traders who do not have … a sustained effort on sustainability.”

Across all of the pension funds we studied, there are three main considerations of whether to divest: 1) the severity of the violation; 2) whether the pension fund believes it can improve the company’s behavior with regard to the human rights impact; 3) and, the relevance of the issue to the existing company policies, i.e. if the allegation involves one of the pension fund’s flagged issues. For most of the pension funds, the decision to divest comes from the board of directors or from director-level advisory committees. Two of the pension funds also suggested that they take this information to the pension holders to make the final decision on divestment via designated oversight committees, or fund boards. One of the interviewees characterized its “highest ranking” officials as the pension holders themselves, which are part of a separate board that oversees the pension fund’s operations, and another acknowledged that bringing divestment decisions to clients is “quite important.” Several of the interviewees stated that in some cases they have chosen not to divest from particular companies because the pension holders did not want to divest and did not view divestment as a priority. For instance, one of the managers stated that her fund has not divested from tobacco companies because its pension holders have not identified that as an issue that is important to them.

Based on reviews of their websites and media reports, we found that all of the pension funds we studied had had at least one instance of divesting after the engagement process had failed to produce change. For example, one pension fund found labor violations by one of its investee companies and began a nearly four-year-long process of engagement that ultimately ended in divestment. It engaged with the company through meetings with the company management and by collaborating with other institutional investors in that company to exert greater pressure on management. The pension fund requested that the investee submit progress reports to show it was improving; however, it divested after it did not see satisfactory change. In another case cited to us during interviews, a separate pension fund engaged with an investee company and with the country's government where the violations were taking place. In the end, this pension fund decided to divest because the investee company would not change its policies and the pension fund could not guarantee that more violations would not occur.

B. Sources of Information

Human rights advocates and affected communities have a strong interest in investors who are well informed about the realities on the ground prior to their commitment of funds. Investors share this concern. Good and timely information is especially critical in the case of illiquid investments, such as infrastructure, where selling the securities in question would likely bring great cost to the investor. The transactions can even have legal consequences, depending on the investment contract. Legal impediments may even prevent the investor from trading at all.[38]

The reliability of information on investment-related human rights risks is a key challenge.

Lack of "availability, reliability, and thoroughness" of information was cited as a barrier to effective human rights due diligence by practically all of the interviewees. One manager called it "something of a blocking factor." Another said, "Collecting information can be a big barrier, certainly, and …we have to depend a lot on our [external research] consultants for what they can provide." In her view, the challenges of substantiated facts are reflected in frequent disagreements between companies and civil society. Referring to an on-line resource that tracks the human rights impacts of over 7,000 companies worldwide and seeks company responses when that company has been accused of involvement in a human rights abuse,[39] she noted "in a lot of the cases that come up in the Business & Human Rights Resource Centre, often the disputes are on the facts." There was only one interviewee that felt that their organization did not face any barriers in this regard: "We've always been able to get good information when we need to."

[38] Thijs Markwat et al., *The Ins and Outs of Investing in Illiquid Assets: A Review of the Most Important Aspects When Considering Investing in Illiquid Assets*, Robeco, July 2015, p. 3, https://www.robeco.com/media/5/3/d/53dd926104b0fe29f7be3fe79b5f0a38_20150922-the-ins-and-outs-of-investing-in-illiquid-assets_tcm18-1887.pdf. (accessed March 22, 2018)

[39] Business & Human Rights Resource Centre, www.business-humanrights.org. (accessed March 29, 2018)

External data providers such as subscription databases and financial research groups, which are a major resource for all the fund representatives with whom we spoke, were also not regarded as a foolproof answer. One interviewee expressed a concern that the information available in databases is not always thorough or up-to-date. The information in these databases is usually "just media clippings," which need to be independently verified before making investment decisions. She also noted that subscription databases like MSCI are costly, and fees often increase prohibitively to get more detailed information. Another interviewee believes that the external consultants and researchers that populate these databases and provide other information to investment managers sometimes lack substantive, in-depth understanding of human rights issues, and even of the meaning of associated vocabulary, which impedes their ability to identify, or accurately assess, relevant information on human rights risks.

Tellingly, most of the interviewees expressed a need for more detailed, verified information about human rights risks and impacts in their investments, especially from civil society, and called for substantiated evidence and documentation. One said, "[I]f we are provided with documentation so that we can build a case, that is very valuable for us." Others spoke of a problem of receiving unsubstantiated claims of human rights impacts from NGOs. One investment manager said that when investors receive "flaky information once, it puts them off ten times. They want reliable information." She also noted that information providers typically "under-utilize … independent verification of facts. Where there is smoke, there is fire." Most of the interviewees, however, said that it is a significant challenge to independently verify claims because of incomplete or biased information and the costliness and difficulty of conducting site visits.

Investment managers are overly reliant on information from external data providers, whose information is often incomplete.

Our interviews pointed to a heavy reliance on external data providers. All interviewees contract external ESG data providers, researchers, and consultants to provide information on investments, in particular MSCI ESG,[40] Sustainalytics,[41] and RepRisk.[42] These tools are valued as "very context-specific" and yet some told us that their reliability depends on investment type or asset class. Several interviewees find that there is a general lack of concrete information available on the human rights practices of companies. This pertains not just to the *amount* of information, but also the *depth* of the information. One interviewee pointed out that there is usually sufficient information available on well-known, large companies operating in developed markets, but information is scarce for firms operating in emerging markets. Another interviewee said that information on human rights risks and impacts is inadequately reflected in company self-reporting, which he called an important resource for his fund's investment teams. He explained that the organization is working to have human rights better integrated into risk reporting standards, such

[40] MSCI Inc, "ESG Integration," www.msci.com/esg-integration. (accessed March 29, 2018)
[41] Sustainalytics, "Solutions," www.sustainalytics.com/our-solutions/. (accessed March 29, 2018)
[42] RepRisk AG, "About RepRisk," www.reprisk.com/. (accessed March 29, 2018)

as SASB. The assessment of the quality of that information provided by an investee company is further complicated when that company hires a consultant to write the ESG reports because it "adds another layer for follow up." Another interviewee considered it important not to be overly reliant on information provided by the company so as to ensure an impartial assessment and diverse perspectives on the issue.

All of the interviewees stated that they rely on NGOs to provide information about human rights impacts. Some of the responsible investment managers say they cultivate their own network of NGO contacts, and are in regular contact with them as issues arise. One interviewee went so far as to say that civil society watchdog accounts of companies' activities is a "fundamental component of his organization's tools for ensuring that they invest responsibly." Another spoke of having a very trusting relationship with both domestic- and foreign-based NGOs.

The way in which funds receive information from civil society, however, varies widely, and appears to depend on circumstances and context. One interviewee explained that her organization was in regular contact with the UN and with NGOs to share research findings and jointly contribute to the development of best practices. Others appeared to rely more on publicly shared NGO reports, as well as information aggregators such as the Business & Human Rights Resource Centre, mentioned above.

Three interviewees used the phrase "open door policy," or a similar term, to describe their attitude towards NGOs and information-sharing, emphasizing that they seek to engage directly with advocates on a bilateral basis, rather than conducting the conversation publicly via the media. In one manager's experience, an informal conversation is more effective and efficient, although he noted that staffing constraints impact this engagement: "[W]e only have six people, so we can't fill our time filling out endless questionnaires and having tons of meetings—there is always a trade-off there." Another interviewee expressed a much greater reliance on formal avenues. She referred to an email address provided on their website and pointed to their FAQ section as the main channel that NGOs should use to raise the organization's awareness of problematic investments.

"Investor-friendly" information about human rights risks in demand.

More than half of the interviewees said that their organization is better equipped to respond to human rights concerns when advocates bring up issues pertaining to specific investments, as opposed to high-level conversations about human rights considerations in general. In this context, some interviewees also believe that it would facilitate more efficient responses if the NGO representatives that approach them had better knowledge of the procedural constraints of investors. One interviewee specifically suggested it would be helpful if NGOs better familiarized themselves with the investors that they engage with, for example, by ensuring that they know and understand what kinds of investments each investor is involved in.

To that end, more than half of the interviewees emphasized that they are better positioned to handle human rights issues when there is a "business case." One interviewee said, "[E]motions don't work; they need to come with a financial reason why these issues, human rights, climate change, etc., will impact our evaluations." He suggested that "investor-friendly information" on human rights risks in certain markets would be welcomed, though he did not specify what constitutes "investor-friendly."

Interviewees also noted that the expectations of NGOs do not always align with what pension fund managers see as feasible, both in terms of outcomes and processes. "Quite often, [NGOs] want us to act quicker or take another stance, but that's just how it is." Investors may wish to collect information and may indeed use it to enrich and improve their processes, but that will not always translate into action in a specific instance. Surprisingly, in one interviewee's experience, the goals of civil society and pension funds are hardly compatible at all: "My impression of activists and NGOs is that they don't really care about us as a fund, they don't really care about what our mandate is in terms of making returns, what they care about is utilizing pension funds to raise awareness about their campaigns on a company." This view, however, was in the minority; several of the interviewees expressed reticence to engage with NGOs for fear of negative publicity, but nearly all of them stated that they believe that it is important to build constructive relationships with civil society organizations.

C. How Pension Fund Managers Understand Human Rights

One of the principal challenges identified by both human rights advocates and ESG professionals we spoke with is a lack of human rights awareness among investors. Investors—both asset owners and asset managers—are often uncertain of what constitutes "human rights" and unaware of their responsibility for addressing rights violations when they occur. Moreover, investors may not be aware of all the ways in which investments can negatively or positively affect individuals and communities outside of direct impacts like labor conditions. Multi-stakeholder initiatives (MSIs), such as the UN Principles for Responsible Investment and the Equator Principles, and guidance targeted at financial actors, such as the OECD guidance on Responsible Business Conduct for Institutional Investors, have helped to bridge this gap by defining how existing corporate responsibility norms apply to the financial sector.

These standards have not yet been internalized by the individuals and institutions making investment decisions, however. The ESG commitments of many institutional investors include references to "social" risks without clearly indicating what the institution considers falling within this broad category. Further, financial institutions tend to silo their human rights and sustainability commitments and screening standards within "socially responsible investment" departments and most have not yet integrated them throughout their operations.

Pension funds' policies invoke international human rights standards, yet implementation gaps remain.

All of the pension fund managers interviewed referred to at least some international human rights standards as a part of their corporate social responsibility (CSR) commitment. In our interviews, the Universal Declaration on Human Rights, the International Covenant on Civil and Political Rights, and the International Covenant on Economic, Social, and Cultural Rights, were referenced, indicating that ESRM staff had an awareness of these norms as relevant to their work. Over half of the interviewees also referred to the International Labor Organization Core Conventions, the UNGPs on Business and Human Rights, and the OECD Guidelines.

Yet implementation gaps remain between policy and practice. Most of the pension funds we studied have, at a minimum, a set of principles and a general roadmap for addressing human rights risks and impacts in their investments. This means that awareness of human rights norms and issues is gaining traction among pension funds, though it is not always clear whether policy commitments to respect human rights penetrate down to mainstream investment managers (that is, those managers responsible for investments in traditional assets rather than responsible or impact investments). As noted above, human rights knowledge seems to be mostly limited to responsible investment teams, which serve as knowledge hubs for portfolio managers on human rights issues.

As more clients demanded attention to responsible investment, however, senior management is under increasing pressure to focus on human rights and other sustainability issues. One interviewee referred to increasing pressure on the clients themselves as a source of the push for responsible investment, noting that "participants and pensioners attach growing value to the knowledge that their money is invested responsibly [and] civil society organizations challenge our clients on this issue with greater frequency."

Most interviewees told us that their fund considers human rights to fall within the category of "social" risks—even during the interviews they would use the two terms interchangeably. Only one respondent made an explicit distinction between social risks and human rights risks, stating that "social" is too broad and undefined a concept and that the term may detract from the integration of more clearly outlined international human rights standards into investments: "It's important that the language we use reflects [international human rights standards] when discussing violations of those standards. We know, however, that in the investment world human rights is part of the 'S' under ESG." When asked about "social and human rights impacts," interviewees tended to discuss the labor impacts of their investments rather than broader human rights impacts, using examples such as forced labor, child labor, health and safety, and collective bargaining rights. Despite this, only one pension fund explicitly indicated that its conception of social and human rights risks primarily refers to labor rights, while others were able to speak about a broader consideration of human rights impacts that affect local communities and other project stakeholders besides workers. One interviewee said that her organization does not discuss human rights separately from ESG issues, pointing out that some issues, like climate change, are both environmental risks and human rights risks.

Mainstream portfolio managers often have incomplete knowledge of human rights standards.

The pension funds we studied vary substantially in terms of where they are along the path of developing an investment framework that is aligned with international human rights standards. Several pension funds' responsible investment policies commit investment managers to incorporate the UNGPs, OECD Guidelines, and other international human rights standards into investment decisions, whereas policies of other pension funds are vague about the specific standards that they adhere to. One of the biggest obstacles for pension funds is that mainstream portfolio managers lack knowledge of human rights.

Most interviewees reported that the scope and depth of human rights understanding varies by asset class and investment function, indicating that knowledge of human rights is not uniform within each institution. This is partly due to the inherent challenges of translating human rights concepts for portfolio managers, especially when the link between an investment and a negative impact is complex or indirect (for example, the right to an adequate standard of living or the right to cultural heritage).[43] As a result, human rights impacts beyond the most severe abuses may be devalued or overlooked by portfolio managers, particularly when the financial implications are not easily quantifiable. One interviewee explained that investment managers responsible for long-term assets where the pension fund holds a larger stake, such as infrastructure projects, tend to work closely with his team to assess human rights concerns and have a better understanding of human rights issues. Yet, he added: "On the other hand, there are other investment products [such as] technical products where it is difficult to understand where human rights are impacted [...] and they do not care about these [considerations]."

IV. Key Takeaways and Recommendations

A. Key Takeaways

ESG and human rights risks are routinely considered in pension funds' investments, yet knowledge of these topics across institutions, including external investment managers, is limited.

Based on the interview responses, pension funds acknowledge the need to integrate ESG

[43] These rights are laid out in several normative human rights frameworks. Article 11 of the International Convention on Economic, Social, and Cultural Rights (ICESCR) recognizes "the right of everyone to an adequate standard of living for himself and his family, including adequate food, clothing and housing, and to the continuous improvement of living conditions." Article 15 of ICESCR recognizes "the right of everyone to take part in cultural life," and the UN Declaration on the Rights of Indigenous Peoples (UNDRIP) recognizes the right of indigenous peoples to maintain their heritage and customs, including the protection of cultural and spiritual sites, rituals, and objects (Articles 11, 12, and 31).

risk assessment and prevention of adverse impact into the investment process. At the same time, there appears to be an understanding with the ESRM function of the need to more deeply incorporate human rights into risk assessment. The interviewees reported that knowledge of international human rights norms is inconsistent across their organizations, and that this is particularly an issue with external investment managers. Fund managers often lack comprehensive knowledge on these topics and most have not been trained.

Lack of information on human rights risks is a central issue for investors.

In both our formal interviews and informal conversations with pension fund managers, the problem of a lack of information came up repeatedly. Interviewees emphasized that their ability to address human rights impacts is only as strong as the information they have about the situation on the ground. Responsible investment managers rely significantly on engagement with civil society, including dialogue and written reports, to gain an awareness of the human rights risks and impacts of their investments. Overall, the investment managers interviewed prioritize sourcing information from a range of independent sources that reflect all stakeholders, including local communities. Our conversations with managers did not yield specific details on the breakdown of sources of information per asset class or investment type, however virtually all of the interviewees reported that they use a combination of resources. In addition, all the pension funds contract with external ESG data providers, researchers, and consultants to some degree, and all the managers recognize the value of civil society contributions, which one interviewee stressed "definitely inform our investment processes."

Procedures funds use to monitor investments may leave out important human rights-related information, and best practices in this area are still emerging.

All of the individuals we interviewed agreed that risk assessment and continual monitoring of investments are important aspects of fulfilling their due diligence obligations to prevent and mitigate adverse human rights impacts. However, the extent to which this assessment is carried out varies across pension funds. With investments across thousands of companies, most of the pension funds use specific tools or methods to facilitate the monitoring process, such as the dashboards described above. While we were not always able to assess the extent to which managers rely on these types of tools, there is a risk that overreliance on them will cause investment managers to focus too narrowly on individual impacts rather than considering the interlinkages between different human rights (for example, a community adjacent to an agricultural investment may not need to be resettled, but may nonetheless suffer human rights impacts directly or indirectly caused by the investment, such as water pollution, lack of access to relied-upon natural resources, or increased poverty). As a consequence, investments within the portfolio that do not appear to present immediate human rights risks are often overlooked. In particular, ongoing monitoring of human rights impacts is a developing practice area for pension funds and other investors, and many are experimenting with the best methods to carry out their due diligence in this regard—while acknowledging that this is still a relatively underexplored area.

Lack of internal capacity is an obstacle to thorough human rights risk assessment and monitoring.

Part of the challenge pension funds face in undertaking human rights due diligence is a lack of internal capacity to assess and monitor a large number of investments. For a pension fund that has not mainstreamed human rights risk analysis throughout its operations, it can be impossible for a small ESRM team to conduct a thorough human rights risk assessment for all of the investments in the pension fund's portfolio, which can number in the thousands. Providing the tools and resources to conduct human rights risk assessment to all investment managers, and making that a priority, could help to alleviate the pressure on the ESG team. Similarly, receiving accurate and timely information about investments where there are adverse human rights impacts would help pension funds to carry out their human rights due diligence.

Engagement and activist shareholding are preferred methods of engagement.

Pension fund managers told us they view company engagement and activist shareholding as the most important tools to mitigate adverse human rights impacts. Throughout all of our interviews, engagement was described as a way for pension funds to bring about positive behavior changes in their investee companies. Engagement allows pension funds to maintain their influence over investee companies. For engagement to work, however, there must be clear parameters and expectations set out from the start. Dialoguing with investee companies or voting for policy improvements at shareholder meetings is one aspect, but the most thorough pension funds also described engagement with civil society and requiring progress reports or other types of evidence to prove that meaningful change was being made on the part of the investee company. At times, engagement also involves working with fellow shareholders to increase their leverage with the investee company. And although all of the pension funds described divestment as a last resort, a few have divested from certain companies when the aforementioned engagement process failed to produce results. Divestment not only signals a serious commitment on the part of these pension funds to fulfil their due diligence obligations, but it also sends a powerful message to both the investee company and those affected by the adverse impacts.

Obstacles to communication between investors and advocates remain, but investment managers strongly value engagement with NGOs.

There are some important differences in attitudes among interviewees about the role of human rights advocates in pushing for responsible investments, with some expressing that the watchdog role of NGOs is essential to their organization's efforts in that field, whereas others are cautious when engaging with human rights advocates. The overarching trend, however, is that interviewees seek more substantive information from NGOs. Generally, they also suggest that better knowledge among human rights advocates of the policies and processes of investors would facilitate more fruitful collaborations. This applies equally to an understanding of different asset classes and an understanding of the investor with which NGO representatives engage in a given case.

Interviewees spoke of the importance of building relationships between NGOs and their institutions. Some are already engaged in a regular dialogue with NGOs and others look to civil society when need arises for specific expert information, or better proximity to affected communities. Despite the general consensus that engagement with NGOs can enrich investors' processes and render them more resilient, some interviewees had clear reservations about the capacity and will among NGOs to produce the "business case" information necessary to get the attention of their colleagues making the deals. Although most interviewees appear to consider civil society engagement an important component of their responsible investment approach, they struggle to match their own perspectives with that of civil society.

B. Recommendations

A repeated message from pension fund managers with whom we spoke is that they want to be able to quantify the cost of human rights violations in order to better the case internally and to their business partners for taking preventative steps to avoid harm. Making an effective business case is critical for many businesses, and there is a belief not just among pension fund managers, but within the business and human rights field at large, that the strongest business case is one in which the costs of doing nothing can be calculated.[44] Yet, there is a risk that assigning monetary value to nuanced and complex human rights issues will underemphasize some human rights concerns and miss others altogether. Furthermore, it may be costlier in some cases to take action to comply with international human rights standards. Thus, while it is important to acknowledge the desire among interviewees to develop a "business case," our recommendations emphasize areas that do not entail quantifying the costs of human rights abuses.

Our key recommendations revolve around two central topics, which are outlined in detail below:

1. **Closing the communication and information gaps**: Despite often sharing the priority to minimize harm in investments, communication gaps between advocates and pension fund managers persist. Human rights advocates do not always know how to best convey information to investors, while managers at pension funds said that they have difficulties gathering information regarding risks and abuses on the ground. Improved coordination

[44] This is evidenced by recent reports that seek to determine objective data on the financial costs of conflict between companies and communities, notably Rachel Davis and Daniel Franks, *Costs of Company-Community Conflict in the Extractive Sector*, Harvard Kennedy School, Corporate Social Justice Initiative, 2014, https://www.hks.harvard.edu/m-rcbg/CSRI/research/Costs%20of%20Conflict_Davis%20%20Franks.pdf (accessed March 22, 2018). (accessed March 29, 2018)

among multiple pension funds could make investee company engagement more effective when human rights abuses arise.

2. **Facilitating human rights mainstreaming**: Pension funds managers are aware that human rights knowledge is not uniform within the companies. This relates to the functions of departments, outsourcing asset management, or even to investors' limited awareness of the topic.

Pension funds should develop channels for civil society to communicate directly with pension funds about: 1) risks in particular asset classes, industries, etc. before investments take place; 2) specific cases and complaints after investments take place.

Nearly all interviewees emphasized that timely, reliable information is a challenge. While funds vary in terms of preferred methods for communicating with NGOs (some preferred informal conversations, while others preferred following specific procedures), communication would improve if all companies established and clearly published information of who to contact. Through our conversations with interviewees, we gained a sense that the responsible investment team within most pension funds is the most effective first point of contact for NGOs and impacted communities wishing to alert the fund to negative human rights impacts. In the absence of a formal grievance mechanism for external stakeholders, which are virtually nonexistent among investors and asset managers, the responsible investment function seems to be best-placed to both understand the issue and to escalate and amplify it within the organization.

Pension funds should initiate trainings and workshops for employees and investee companies on how to adequately address human rights risks.

Nearly all of the interviewees made the point that human rights complexities were not well understood by fund managers outside of the responsible investment functions. Furthermore, our research of pension fund policies revealed that some human rights are not formally recognized in policy statements and other documents. For example, it is common to see anti-tobacco guidelines in ESG polices, but rare to see issues such as access to water and land rights. There is a clear opportunity for additional training and human rights education for fund managers, particularly portfolio managers with less exposure to the concepts. For this to occur, a pension fund's executive management should set aside funds and prioritize human rights training and education as a core component of professional development. Knowledge of human rights norms and impacts also needs to be passed along the investment chain to external asset managers for instances in which this is not already being done. By implementing clear policies, expectations, and oversight mechanisms on human rights integration for external asset managers, pension funds can lower human rights risks and preserve their own responsible investment values as they do for internally managed assets.

Pension funds should also make it clear to investee companies that human rights considerations are a priority when considering new investments and evaluating existing ones. Where they do not already exist, pension funds should, prior to investment, clearly state expectations that prospective investee companies undertake human rights due diligence. This includes implementing accountability mechanisms, such as formalized reporting or periodic in-person meetings on existing and potential human rights risks.

Several interviewees said that they are interested in developing internal human rights training programs; some are already in the process of doing so. One pension fund already offers workshops for both internal staff and investee companies, creating an opportunity for stakeholders to better understand how to prioritize human rights. This approach could provide a model for other funds. It is critical that these priorities are reinforced outside of the training programs, however. While the responsible investment program in every pension fund we reviewed had support at the highest echelons of the organization, fund leadership should take a more active role in ensuring that these values are realized by strengthening human rights risk assessment procedures.

Pension funds should mainstream human rights capacities and responsibilities throughout the pension fund rather than siloing the human rights due diligence in one unit.

Over half the interviewees noted that their responsible investment units tend to be understaffed, lacking the human capital to conduct the required due diligence for the vast number of investments. By building the capacities of all fund managers to consider human rights as a key part of their investment strategy, responsible investment strategies can be better operationalized. Additionally, pension funds should ensure that their ESG or responsible investment teams have the necessary financial and human resources to monitor their existing investments in full, which most interviewees acknowledged was an existing challenge.

Pension funds should implement clear policies, expectations, and oversight mechanisms on human rights integration for external asset managers.

Pension funds that outsource their asset management function need to pay close attention to how external asset managers assess human rights impacts. They should insist that they have thorough knowledge of human rights norms and higher quality information about human rights impacts. By developing clear policies, expectations, and oversight mechanisms on human rights integration for external asset managers, pension funds can lower human rights risks, preserve their own responsible investment values, and ensure the same asset management quality with internally managed assets.

Pension funds should strengthen policies regarding land rights.

Land rights risks, including insecure tenure, forced eviction and resettlement, and loss of access to traditional lands and resources, are common in investments in infrastructure and development projects in emerging markets. Many of the pension funds we researched are directly or indirectly invested in projects that have posed serious risks to community land rights. Nonetheless, most did not have clear policies on land rights and forced evictions, focusing instead on child labor, which they referred to in our interviews as “most severe violations.” Some of the interviewees noted that they look for certain red flags as part of their risk management framework, and if those indicators are not there, the investment passes without further scrutiny. Land rights need to be included among those red flags, with specific indicators, such whether the investee company has consulted relevant stakeholders. It is critical that pension funds take this step now, at this moment when they are ramping up their investment in large-scale infrastructure, which carries high risks of forced displacement.

Pension funds and advocates should form coalitions of pension funds to engage with companies.

Interviewees expressed a preference for engagement with investee companies over divestment when human rights issues arise. Several noted that coordinated action among multiple investors of a given investee company had been effective in the past, particularly with respect to climate change and fossil fuel divestment. In these cases, coalitions of shareholders influenced company behavior by presenting resolutions and voting as a bloc at shareholder meetings. There is an opportunity for advocates to play an active role in coordinating such action by consolidating support among multiple pension funds that are invested in a problematic project or company.

Advocates and external research providers should improve data collection methods to better incorporate civil society.

All of the interviewees use external ESG data providers to obtain information on human rights risks, such as MSCI ESG, Sustainalytics, and RepRisk. Yet the information they provide tends to be spotty and is sometimes outdated. According to one interviewee, service offerings of these providers “would be greatly enhanced if they received first-hand information from reputable NGOs and civil society associations.” ESG service providers should improve avenues for consultations with NGOs and civil society organizations. They should also disclose how, and how often human rights risks are monitored on an ongoing basis.

V. Conclusion

The UNGPs and the OECD Guidelines mandate that investors take responsibility for the human rights abuses that may result from their investments, and advocates will continue to push for adherence to these standards. As pension funds expand into new areas that have complicated human rights risks, it is important for those making the investment decisions to have a solid understanding of the implications of their investments and how to respond to incidents of human rights harm. All of the pension fund managers that we spoke to have human rights policies. However, adherence to international norms cannot stop with the creation of a human rights policy, and both pension funds and human rights advocates must work together to ensure that the goals of these international instruments are realized.

The main challenges pension funds face are a lack of understanding on the part of investment managers as to what encompasses human rights risks, and a lack of capacity or mandate within the pension funds to mainstream the "ESG" or "responsible investment" functions across the entire organization. Moving forward, the key to effective implementation of and adherence to international norms will be clear signals from both the investment community and the human rights community of a willingness to work together, to bridge the communication and information gap, and to improve the methods by which pension funds and other investors analyze and respond to human rights risks in their investments.

Annex: Research Methodology

This study relied on desk research of pension fund strategies and interviews with pension fund managers carried out in March and April 2017. The list of potential interviewees was developed through our existing networks, an approach that could bias the results. This list included individuals that work for three types of entities: pension funds, organizations that manage investments for pension funds, and an oversight body. For the sake of simplicity, we refer to the individuals as “pension fund managers” or “interviewees” throughout the report.

We contacted the pension fund managers via e-mail, introduced them to our project, and invited them to participate in a one-hour phone interview. At the end of each interview, we asked for additional contacts at the pension fund, particularly those working in fund management. None of the individuals working in fund management returned requests to be interviewed; as a result, the sample consists only of those working in responsible investment, or ESG, functions. The findings therefore reflect the perspectives of pension fund managers that have a stronger baseline understanding of and favorable disposition towards human rights.

Eleven of the interviews were conducted via Skype or phone; one was conducted in person. Before each interview, we extensively researched the specific pension fund and tailored the interview questions to ensure we used the interview time to elicit information not already in the public domain. To make the discussion as concrete as possible, during our desk research in advance of the interview, we sought to identify high risk projects the fund was invested in, and in some cases we referred to these examples during the interview. At the start of each interview, we asked for permission to record the interview and provided assurances of anonymity in the research report. As a result, we have not attributed manager or fund names to particular quotes or findings.

The interview questions were developed through an iterative and participatory process; we sought to address questions human rights advocates often come across when considering how to effectively engage pension funds to prevent or mitigate human rights violations in their investments. We drafted an initial list of interview questions, sent them to advocates and academics working in the responsible investment and human rights field, and set up informational interviews to receive feedback. In addition, we pilot-tested the interview questions with a responsible investment advisor, and video-taped the pilot.

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