Principles for Responsible Investment

HUMAN RIGHTS IN SOVEREIGN DEBT: THE ROLE OF INVESTORS

An investor initiative in partnership with UNEP Finance Initiative and UN Global Compact

THE SIX PRINCIPLES

PREAMBLE TO THE PRINCIPLES

As institutional investors, we have a duty to act in the best long-term interests of our beneficiaries. In this fiduciary role, we believe that environmental, social, and governance (ESG) issues can affect the performance of investment portfolios (to varying degrees across companies, sectors, regions, asset classes and through time). We also recognise that applying these Principles may better align investors with broader objectives of society. Therefore, where consistent with our fiduciary responsibilities, we commit to the following:

1 We will incorporate ESG issues into investment analysis and decision-making processes.

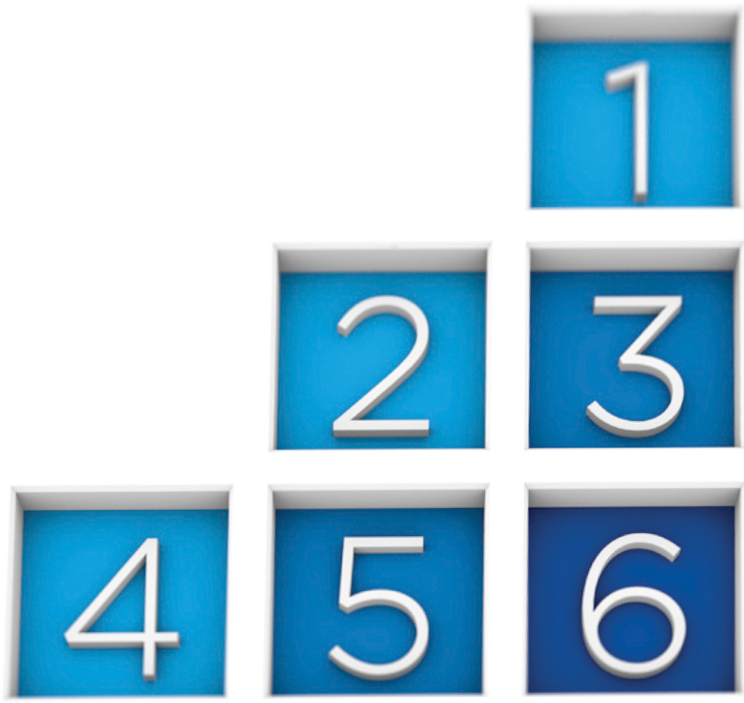
2 We will be active owners and incorporate ESG issues into our ownership policies and practices.

3 We will seek appropriate disclosure on ESG issues by the entities in which we invest.

4 We will promote acceptance and implementation of the Principles within the investment industry.

5 We will work together to enhance our effectiveness in implementing the Principles.

6 We will each report on our activities and progress towards implementing the Principles.



PRI's MISSION

We believe that an economically efficient, sustainable global financial system is a necessity for long-term value creation. Such a system will reward long-term, responsible investment and benefit the environment and society as a whole.

The PRI will work to achieve this sustainable global financial system by encouraging adoption of the Principles and collaboration on their implementation; by fostering good governance, integrity and accountability; and by addressing obstacles to a sustainable financial system that lie within market practices, structures and regulation.

CONTENTS

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EXECUTIVE SUMMARY

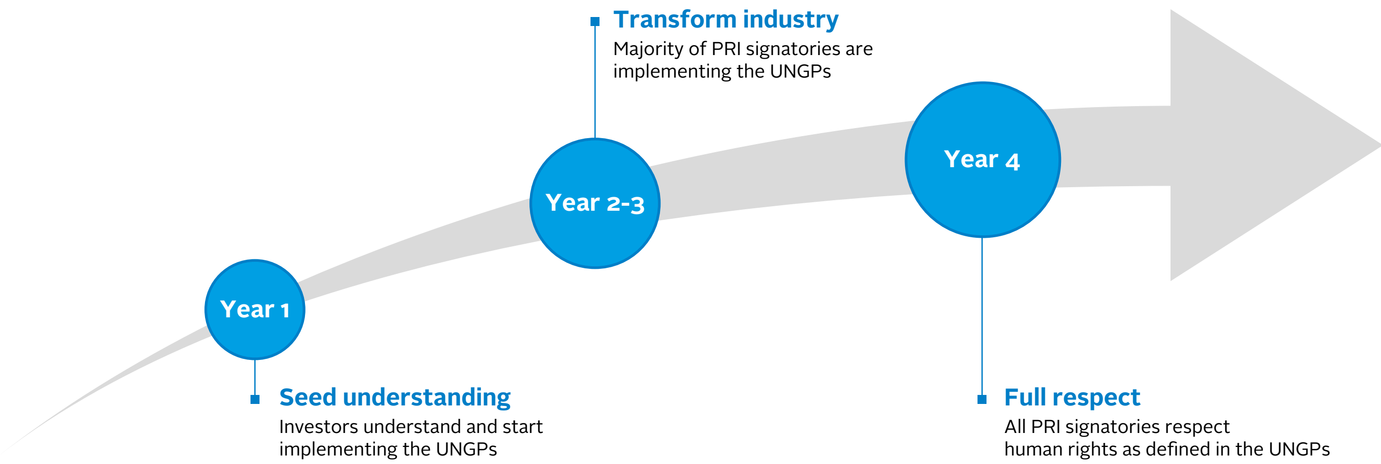
A decade has passed since the adoption of the Ruggie Principles, the UN-sponsored effort to put human rights onto the boardroom agenda after decades of globalisation. The UN Guiding Principles on Business and Human Rights (UNGPs), as they are formally known, have helped clarify the links between business and human rights but they did not explicitly address the role of investors, including those who fund sovereign debt. Yet sovereign nations are the ultimate guarantors of human rights, making the bonds they issue a logical focus for responsible investors.

Investors in sovereign debt face unique challenges when considering human rights. Like all fixed income investors, they do not own a stake in issuers, making engagement more challenging than for equity investors. Additionally, pressing a state on human rights violations can raise political sensitivities around issues of sovereignty.[1]

Yet the role of asset owners is crucial: they can proactively set the scope of their investable universe and convey expectations and goals to investment managers, directly or through investment consultants. For their part, investment managers can make clear to clients their in-house ESG policy when replying to requests for proposals and they can flag risks and opportunities when acting on clients' behalf.

As the largest fixed income asset class, the sovereign debt market is an important area for the PRI's work to improve investor practice on human rights, which is a key area of focus in the PRI's 2021-2024 strategy. The PRI recognises that this is a complex topic, requiring time, a change of mindset and collaboration. In its seminal work Why and how investors should act on human rights the PRI set out a multi-year work plan. This paper is part of the year-one strategy (see Figure 1).

Figure 1: Timeline of the PRI's human rights investor agenda



This paper begins by reviewing the inchoate state of investor practices surrounding human rights. It then looks at a range of barriers to investor consideration of human rights. In addition to the perceived threat to sovereignty noted earlier, other challenges include: the lack of leverage compared with investors in corporate bonds; the potential knock-on effects of reduced public funding; and the difficulty of finding an alternative asset to buy in a variety of situations.

The report then walks sovereign investors through a three-step process for meeting human rights responsibilities, inspired by the UNGPs and modelled on the aforementioned PRI paper:

1. Design and adopt a policy;
2. Undertake due diligence to:
   i. identify and assess human rights in a given country;
   ii. decide whether to invest, divest, or alter an existing exposure to a sovereign bond;
   iii. engage with existing or prospective sovereign issuers;
3. Facilitate access to remedy when human rights are breached.

The paper concludes with concrete suggestions for investors seeking to address human rights in their portfolios.

1 See Principles for Responsible Investment (2020) ESG engagement for sovereign debt investors.

MARKET OVERVIEW

Evidence is beginning to show that some responsible investors are incorporating human rights issues in investment decisions.[2] This commonly takes the form of votes at annual general meetings, an avenue open only to equity investors. A small number of examples also exist in the sovereign debt market, for example in relation to human rights issues in Venezuela, Belarus and even the US, although these are the exception rather than the norm.[3]

Fixed income investors are starting to pay attention to the issue, but it is difficult to isolate the direct link between human rights and bond pricing. As with other ESG issues, asset owners generally do not *systematically* ask themselves whether human rights are a material risk to their investment decisions. Nor do they assess whether their asset allocation impacts human rights. Lacking a framework that takes human rights into account, most pension and insurance funds do not give clear indications to investment managers on this topic, directly or through investment consultants when outsourcing portfolio management. What's more, in the rare cases when divestment or engagement happens around human rights, it is usually sporadic or reactive – after a controversy has occurred – rather than proactive.[4]

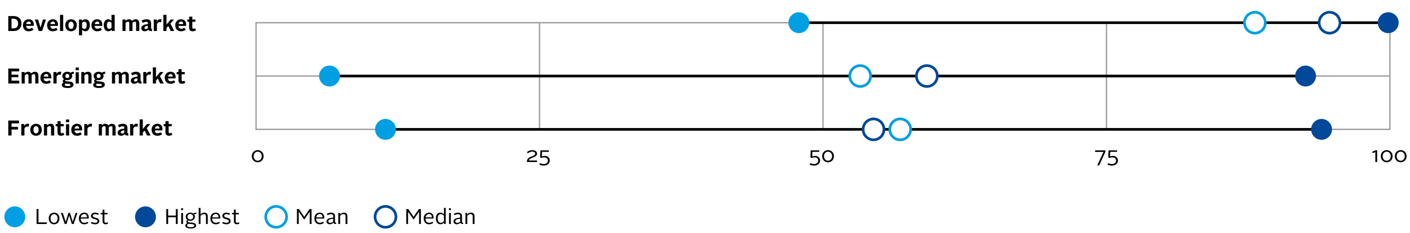
CHALLENGES

Sovereign bondholders face multiple barriers to addressing human rights:

- Focusing on human rights violations raises political sensitivities and can be interpreted as questioning the right of a state to act within its borders (which is at the very heart of the concept of sovereignty).
- Incentives to tackle human rights problems are less clear for sovereign debt investors compared with corporate investors. For corporates, regulatory, litigation and reputational risks may be more apparent and the impact on price more immediate.
- Reducing or cutting off a government's funding may hinder human rights or broader social outcomes by reducing capacity for public spending on pensions, public sector wages and services.
- Substitution is more difficult compared with other asset classes, for example when investors:
  - hold domestic bonds due to regulatory, liquidity or foreign exchange constraints;
  - follow a mandate or benchmark, as there may be fewer interchangeable options for sovereign bonds;
  - buy certain government bonds as a safe haven, especially US Treasuries due to their liquidity and market depth;
  - use government bonds as collateral in the repurchase agreement (repo) market.

Investment mandates that focus on emerging markets also face unique challenges. Emerging market countries often have weaker institutions relative to developed market countries, which can impede economic, social and cultural rights. Civil and political rights can be relatively weaker too. For example, Freedom House's Global Freedom Scores for developed markets average 90, versus 55 for emerging markets and 58 for frontier markets (see Figure 2).[5]

Figure 2: Freedom House Global Freedom Scores by country and territory classification. Sources: Freedom House, MSCI, PRI



2 See Sycomore Asset Management (2019) ESG Integration Policy; PGGM (30 November 2020) Policy Paper Human Rights; Aviva Investment Management (2021) By the people, for the people; abrdn (April 2021) Human Rights – Our Approach for Investments and (September 2021) Position Statement – Governments and Human Rights.

3 See Reuters (August 2017) Dumping Venezuela's debt may just be a start for ethical bond buying; Reuters (June 2021) Analysis: Global funds feel the heat over Belarus 'blood' bonds; Bloomberg (October 2019) ESG Hardliners Blacklist $16 Trillion U.S. Treasuries Market.

4 See ShareAction (May 2020) Point of no returns – Human Rights.

5 We calculated these average scores using the MSCI's classification of markets to distinguish between developed markets, emerging markets and frontier market countries.

This is not to discount the human rights problems that exist in developed countries, despite their higher scores. For example, capital punishment exists in 27 states in the US, whose Treasury bonds form by far the most active and liquid sovereign bond market globally. Furthermore, in many developed countries, discrimination at work and gender discrimination persist. For example, very few countries have met UN Sustainable Development Goal (SDG) number 5 on gender equality, according to the Sustainable Development Report. Finally, many developed markets in effect outsource human rights issues by sourcing suppliers from emerging markets with weaker labour regulations, increasing the risk of forced or child labour.[6]

DRIVERS

These obstacles do not detract from the fact that human rights play a critical role in creating an environment for both citizens and businesses to thrive. The protection of human rights can aid a country's GDP growth, the sustainability of its fiscal path and its credit rating. As a result, human rights are integral to the country-level economic and institutional assessments undertaken by investors (see Figure 3).

Figure 3: How human rights can contribute to sovereign assessments

ECONOMIC ASSESSMENT	INSTITUTIONAL ASSESSMENT
Upholding citizens' human rights can improve a country's GDP growth	**Human rights protection shapes the business environment**
▪ Many human rights enhance people's living standards (such as the right to food, education, work and health) and can determine a country's development, its competitiveness and prosperity. ▪ Human rights abuses (such as persecution and torture) may lead to emigration of the workforce and brain drain. ▪ Human rights violations and sanction risks may deter foreign direct investment amid increasing attention from the international community. This could be to the detriment of domestic production and the balance of payments.	▪ Judicial settings form an important part of a country's institutional strength, including the rule of law and its enforcement. ▪ Laws and regulations delineate corporate business practices. ▪ Protection of property rights contributes to a country's ease of doing business. ▪ Upholding human rights can reduce chances of social unrest and political uncertainty.

The scrutiny of countries' human rights performance is increasingly matched by pressure on investors to prove their responsible investment credentials. Highly publicised movements can expose responsible investors who have failed to consider human rights explicitly in their investment analysis and due diligence processes, and activist pressure has extended to sovereign debt.[7]

Furthermore, regulatory changes aimed at preventing human rights abuses are growing, albeit mostly at the corporate level.

In particular, the European Union is developing a range of rules that will expect corporate issuers and investors to show much greater consideration of human rights. In addition, Australia's Modern Slavery Act 2018 explicitly included investment and lending within its scope.[8] These types of regulatory demands are likely to affect the work of not only legal and compliance departments at investment firms, but also extend to asset allocation and portfolio management teams.[9] In turn, increasing human rights regulations are likely to augment investor scrutiny of country practices as a whole.

6 See IMF Discussion Note (May 2019) Designing Labor Market Institutions in Emerging Market and Developing Economies: Evidence and Policy Options.

7 See Financial Times (July 2021) ESG investing: funds weigh sovereign debt profits against human rights.

8 See KPMG and Australian Human Rights Commission (2021) Financial services and modern slavery: practical responses for managing risk to people.

9 For instance, the EU Sustainable Finance Disclosure Regulation requires financial market participants to publish and maintain on their websites a principle adverse impact statement, clarifying how they consider principle adverse impacts of investment decisions on sustainability factors, and due diligence policies with respect to those impacts or clear reasons for not taking them into account. The statement is intended to show investors and prospective investors how investment decisions have or may have adverse impacts on sustainability factors relating to environmental, social and employee matters, respect for human rights, and anti-corruption and anti-bribery matters.

FRAMING HUMAN RIGHTS

The PRI's report Why and how investors should act on human rights states that institutional investors should meet their responsibility to respect human rights by:

- publishing a policy commitment;
- implementing a due diligence process; and
- enabling or providing access to remedy.

Additional context is needed to apply these steps to sovereign debt investors.

STEP 1. ADOPTING A POLICY

Asset owners, investment managers and investment consultants should start with a clear commitment to respect human rights, whether in the firm's ESG policy or a standalone statement. A policy can be broad, shaping the firm's governance structure to ensure that human rights are considered systematically. It can also be non-prescriptive, given that it precedes the identification of human rights issues in specific countries.

The policy should be:

- approved at the most senior level;
- embedded with proper resourcing throughout the organisation;
- integrated in governance frameworks and management systems; and
- used to inform investment decisions and engagement.

For asset owners, the policy can be used to limit the investable universe by defining rules that restrict investment in certain countries or regions. The policy also should include the process for communicating expectations and giving guidance to investment consultants and investment managers about the objectives of different mandates.

When investing across asset classes (e.g. sovereign or sub-sovereign debt, corporate securities and currencies) investors should ensure that their approach to human rights is consistent across all categories of assets.

To inform policy drafting, investors can take inspiration from common, recognised frameworks to define human rights such as the International Bill of Human Rights and the International Labour Organization's Declaration on Fundamental Principles and Rights at Work. Beyond global treaties, there are also regional, national and sub-national instruments, for example the Council of Europe's European Convention on Human Rights and New York's Human Rights Law.

Moreover, investors can use several classifications of human rights among the many that have been proposed, distinguishing for example between rights to respect, protect or fulfil.[10] The authoritative framework, based on the International Bill of Human Rights, contains five categories: economic, social, cultural, civil, and political. The first three are relevant to a country's economic assessment while the final two pertain to institutional performance (see Figure 4 for non-exhaustive examples of different types of human rights).

Figure 4: Different categories of human rights

ECONOMIC, SOCIAL AND CULTURAL RIGHTS	CIVIL AND POLITICAL RIGHTS
▪ the right to work ▪ the right to a standard of living adequate for health and well-being ▪ the right to education ▪ the right to adequate food, clothing, and housing ▪ the right to take part in the cultural life of the community ▪ the right to enjoy the benefits of scientific progress ▪ the right to social security	▪ the right to life ▪ the right to freedom of expression ▪ the right to asylum from persecution ▪ the right to be presumed innocent until proved guilty according to law in a public trial ▪ the right to freedom of religion ▪ the right to equal protection of the law without discrimination

10 See Henry Shue (1980) Basic Rights.

STEP 2. DUE DILIGENCE

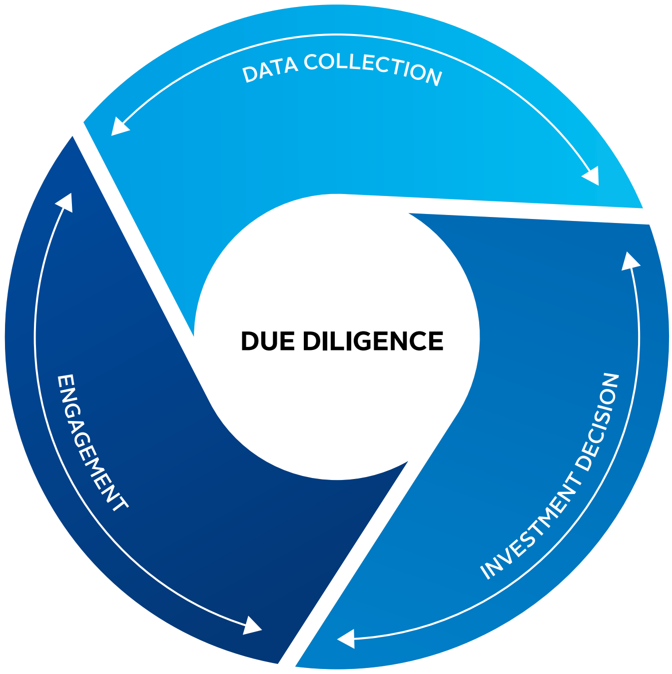
Once investors have adopted a policy on human rights, they can use it to frame the due diligence process, which involves identifying and tracking relevant topics, improving human rights outcomes, and communicating with stakeholders about outcomes and actions. This step, which is undertaken both pre- and post-investment, is relevant for asset owners and investment managers and can be incorporated into the guidance provided to investment consultants.

For sovereign debt investors, there are three main parts to this process:

- data collection
- investment decision
- engagement

These three parts represent a circular process, with each action feeding into the other two (see Figure 5). For example, engagement can help with collecting better data, as well informing or determining the investment decision. These three actions can be conducted on a continuous basis, including before investment and during the holding period.

Figure 5: The circular process of due diligence



DATA COLLECTION

The first step in due diligence is to collect and analyse data that can help investors identify securities with material human rights risks. A wealth of data is available free of charge, although not all content is up to date (see Figure 6).

The data can be used to either research human rights issues that are present at the country level or to look at risks that may attach to bonds issued for a specific purpose.

Figure 6: Useful sources

SOURCE	EXPLANATION
The World Bank: ESG data portal	Contains a range of indicators relevant to human rights, including an index on the strength of legal rights and an estimate of voice and accountability under the governance category. Other indicators are also useful, especially under the social category.
The World Bank: Worldwide Governance Indicators	Reports governance indicators, such as political stability, rule of law and absence of violence/terrorism.
The World Bank: Poverty and Inequality indicators	Contains indicators on poverty.
The Freedom in the World report	Covers political rights and civil liberties, with numerical ratings for countries.
The International Trade Union Confederation Global Rights Index	Reports on workers' rights.
Human Rights Watch	Produces country-level reports on human rights abuses.
OECD (the Organisation for Economic Co-operation and Development): Measuring Distance to the SDG Targets	Assesses how close member countries are to meeting the SDGs.[11]
Sustainable Development Report	Gauges countries' progress in meeting the SDGs.
Human Rights and Business Country Guides	Compile publicly available information on certain countries.
Amnesty International	Provides profiles for individual countries.
UN Human Rights Council Universal Periodic Review	Assesses states' human rights records via peer review.
Global Slavery Index	Gives estimates on the number of people in modern slavery, analyses governments' responses, and highlights vulnerability to modern slavery.
The Global Food Security Index	Examines food affordability, availability, quality and safety, as well as natural resources and resilience, on a country-by-country basis.
UN Development Programme, Human Development Reports	Contains a range of data on social factors within countries, including the Human Development Index, which aims to combine measurements of health, education and standard of living.
Fragile States Index	Ranks countries annually on their stability, highlighting vulnerabilities that increase the risk of state fragility.
International Federation for Human Rights	Publishes ratings of EU countries and the UK that aim to help investors account for how countries meet obligations to respect, protect and fulfil human rights.
International Labour Organization World Social Protection Data Dashboards	Shows data on social protection by country.

11 The OECD has also released a paper on using its methodology to assess other countries: see OECD (2020) How to measure distance to SDG targets anywhere.

The Office of the High Commissioner of Human Rights (OHCHR) has helpfully classified human rights data into three types: those measuring a state's intent and commitment to fulfil human rights obligations; those focused on implementation of policy to meet the state's obligations; and those capturing results.[12]

Figure 7 lists specific examples of data that fall under each category. These distinctions are important, as countries may perform better on some types of indicators than others. For example, it may take time for strong structural and process indicators to translate into outcomes.

Figure 7: Types of human rights indicators. Source: OHCHR

STRUCTURAL	Assess commitment to implement human rights standards	E.g. Number of international treaties ratified
PROCESS	Assess efforts to transform human rights commitments into results	E.g. Budget allocation to specific programmes
OUTCOMES	Assess the results of efforts to ensure human rights	E.g. Proportion of labour force in social security schemes

INVESTMENT DECISION

Once investors have identified, or updated, their assessment of relevant human rights issues, they must decide whether to invest, or remain invested, in a given sovereign bond.

While the UNGPs did not speak to investors directly, number 19 notes that a business enterprise can be linked to an adverse human rights impact through its business relationship with another entity, through its operations, products or services. This principle can be applied to investors (in lieu of business enterprises) that buy debt instruments of a sovereign state. The list below is the PRI's interpretation of the factors that the UNGPs say will be considered when determining the appropriate course of action:

- the severity of a human rights issue (including scale, scope and irremediability);
- the leverage the investor may be able to have over the human rights situation;
- the consequences for human rights in the case of non-investment; and
- the importance of the investment to the portfolio.

Given the interplay of these factors and the fact that human rights are only one of many ESG issues contributing to a country's assessment, the investment decision is not necessarily binary. For example, some investors exclude countries from their investment universe due to their track record on human rights violations (e.g. China, the Kingdom of Saudi Arabia or Uzbekistan). Others may invest in these countries because of their attempts to diversify away from fossil fuels or implement other structural reforms.[13]

Here is where the role of asset owners becomes crucial in clearly stating objectives, risk tolerance and expectations on human rights. Also critical is which benchmark the investment mandate will track or, in the absence of a suitable benchmark, what should the approach be towards country selection. Investment managers also have a role to play, collaborating with asset owners on the identification of actual and potential human rights issues and discussing ways to address them.

12 See OHCHR (2012) Human Rights Indicators: A Guide to Measurement and Implementation.

13 See Financial Times (July 2021) ESG investing: funds weigh sovereign debt profits against human rights.

Once human rights issues have been identified, investors have different options. Figure 8 contains some examples:

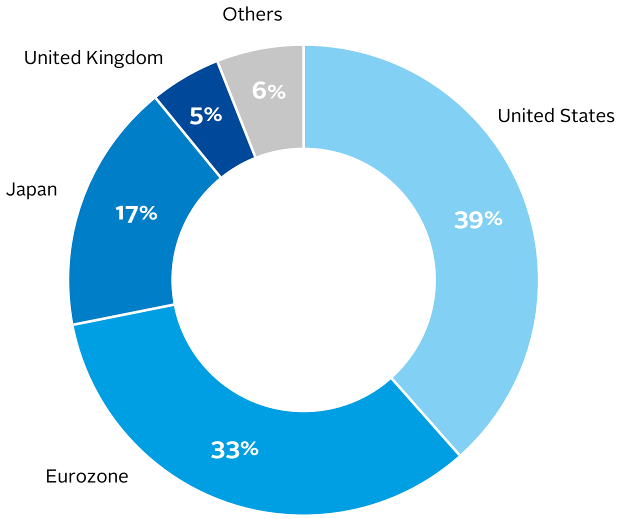
Figure 8: Investor options after identifying human rights issues

Avoid investing or divesting	Some cases warrant exclusion upfront or divestment. The choice of the countries to screen out may be facilitated by sanction lists, whether national or from international bodies such as the EU.
Invest/remain invested	An investor may choose to buy sovereign bonds or remain invested if the human rights trajectory is positive. In this case, a more active investment approach is needed, including ad hoc changes to exposure, tracking of indicators related to human rights, and, where possible, engagement.
Underweight, overweight or neutral	Investors can fine-tune their portfolio construction and, for those who track benchmarks, their exposure relative to the reference index based on human rights considerations. This is where asset owners and investment consultants need to be very clear about which objectives they want to pursue and against which index. There are no mainstream sovereign human rights indices, unlike those for corporates.[14] Therefore, tailored ones may need to be created.

Divestment, if accompanied by a public statement, can grab media headlines and have a powerful signalling effect. However, avoiding exposure may not prove effective in addressing human rights violations, especially if it is not done at scale. Its effectiveness also depends on whether the target country is reliant on foreign capital to fund its spending needs (i.e. if a country has a public and current account deficit, also known as twin deficits) and whether it can access alternative funding sources.

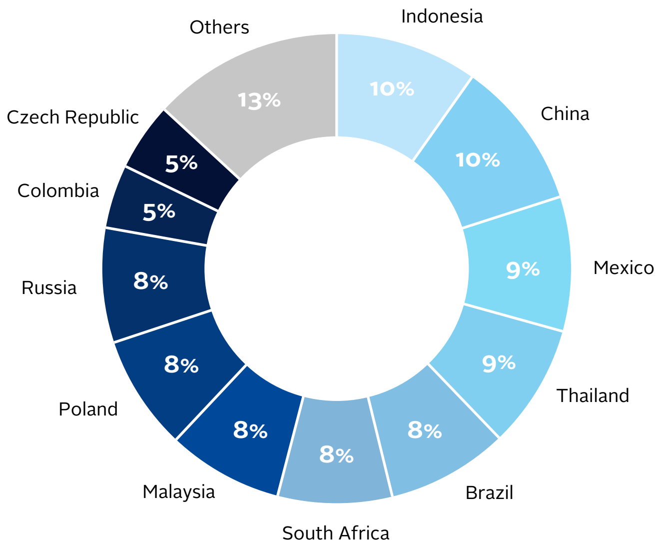
Two additional questions should be considered by those contemplating divestment. One is whether divestment would be severely detrimental to the investor's portfolio returns or ability to track a benchmark. This is a very fine balance, given the difficulty of replacing one sovereign issuer with another, particularly when it plays an outsized role in an index (see Figures 9 and 10).

Figure 9: FTSE World Government Bond Index as of 30 September 2021.* Source: FTSE Russell



*Eurozone countries included are Austria, Belgium, Finland, France, Germany, Ireland, Italy, Netherlands and Spain. The "Others" category includes Australia, Canada, Denmark, Israel, Malaysia, Mexico, Norway, Poland, Singapore and Sweden.

Figure 10: JP Morgan Government Bond Index-Emerging Markets Global Diversified as of 30 September 2021.* Source: JP Morgan Chase & Co.



*The "Others" category includes Hungary, Romania, Chile, Peru, Turkey, Serbia, Dominican Republic, Uruguay and the Philippines. Graph courtesy JP Morgan Chase & Co., copyright 2021.

14 Such as the Corporate Human Rights Benchmark, the Human Rights Custom Index and the Democracy Investments International Index.

In 2018, for example, Danish pension fund MP Pension announced that it would divest 400 million Danish kronor (US$60m) in sovereign bonds from 15 countries that violated human rights because the fund was unable to engage actively with them. However, it remained invested in large issuers such as China and Russia on return grounds.[15] More recently, however, the fund, now called AkademikerPension, has excluded 45 countries in total, including China, as described in a recent case study. This approach, explicitly based on human rights, is rather new and unusual.

A second key question is whether divestment would lead to a worse human rights outcome. A sudden reversal of capital flows may affect countries through several channels (e.g. currency devaluation, higher interest rates, fiscal tightening, macroeconomic volatility and changes in GDP growth), in some instances with negative consequences for living standards and social stability.

Given the many options open to investors and the considerations attached to each, it is important that investors communicate to clients, beneficiaries and affected stakeholders the investment decision process, the reasoning behind it, and how it incorporates human rights and broader ESG concerns.

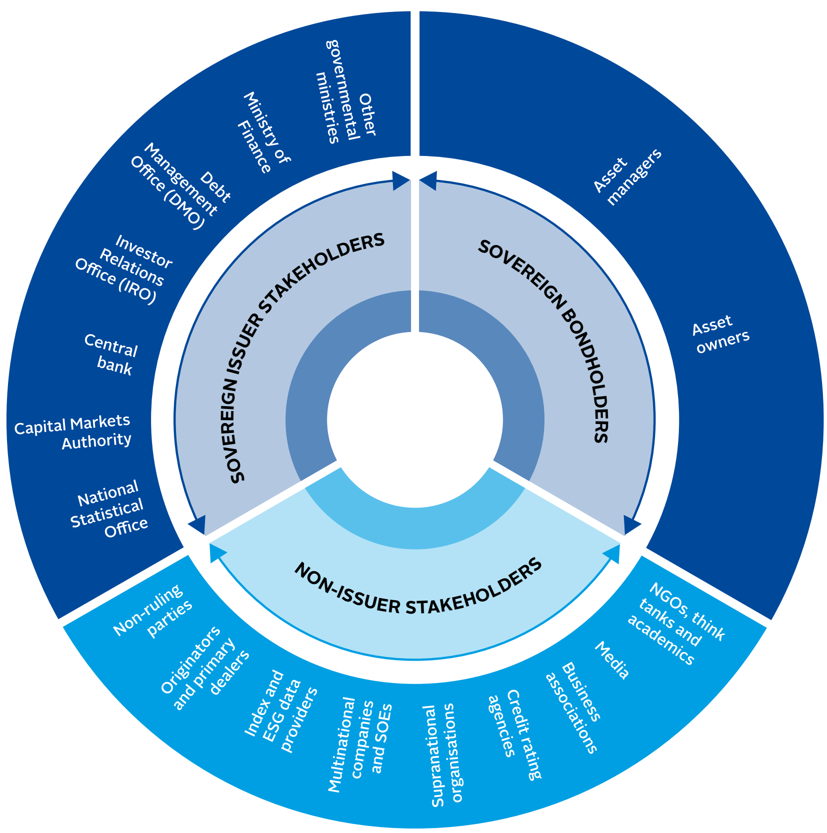
ENGAGEMENT

Engagement enables investors to convey expectations on human rights issues, both before and after investment. As noted earlier, engagement outcomes also feed into research efforts and can inform investment decision-making.

Engaging with sovereigns on human rights is particularly challenging. The PRI's report ESG Engagement for sovereign debt investors noted that the concepts of active ownership and stewardship – at the core of the PRI's Principle 2 – are typically associated with equity investing. Fixed income investors do not hold an ownership stake in issuers, unlike their equity counterparts, making these concepts more difficult to practice. In a sovereign context, engagement could be interpreted as an attempt to interfere in governments' policies within their jurisdiction.

However, engagement is integral to responsible investment in all asset classes; there should be no exception for sovereign bondholders. The perceived challenge of political sensitivities around sovereignty can be assuaged by a multipronged approach to engagement. When a wide array of stakeholders is involved, the lens is wider than the ruling government (see Figure 11).

Figure 11: Sovereign engagement is a 360° process



15 See Pensions & Investments (18 December 2018) Danish pension to divest $60 million from nations over human rights issues.

Finding topics to anchor the discussion

When investors meet government representatives and other state authorities to gain insight on fiscal and monetary policies, human rights issues are implicitly on the agenda. Tax and spending priorities directly impact equitable access to education, health care, and employment, and can promote – or undermine – social cohesion.[16]

Trade deals also have implications for human rights. They can affect regulation, economic growth, wealth distribution, and access to essential products and services.[17]

New topics for engagement are emerging, such as ensuring digital inclusion when expanding technological infrastructure. The digital divide may well have exacerbated educational inequality during the COVID-19 pandemic.[18] An additional issue is the effect on workers of the transition to a low carbon economy. This transition, particularly in the oil and gas, agriculture and renewables industries, could trigger positive and negative changes to the structure of the labour market, community displacements and increased mineral sourcing from countries with poor human rights records.[19]

Cybersecurity is also attracting more attention; preventing cybercrime is required to protect the right to security of a person, a recognised human right. A country's internet governance structure has implications for freedom of expression and the right to privacy. Importantly, the SDGs, many of which are explicitly grounded in human rights, can also anchor conversations (see Figure 12).

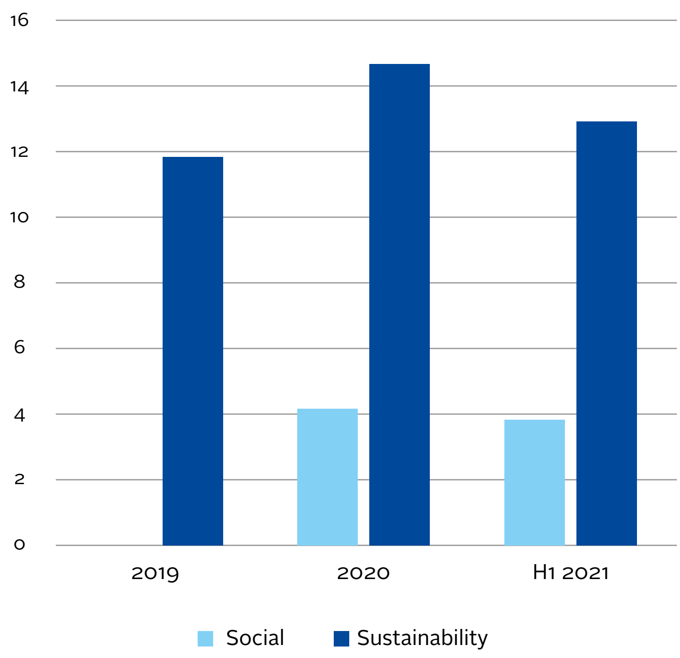
Figure 12: Examples of how human rights relate to the SDGs. Source: OHCHR

1 NO POVERTY	▪ Right to an adequate standard of living ▪ Right to social security ▪ Equal rights of women in economic life
6 CLEAN WATER AND SANITATION	▪ Right to safe drinking water and sanitation ▪ Right to health ▪ Equal access to water and sanitation for rural women
7 AFFORDABLE AND CLEAN ENERGY	▪ Right to an adequate standard of living ▪ Right to enjoy the benefits of scientific progress and its application

Choosing the right opportunity

Country visits, when possible and safe, are an effective way to gather information and to engage with various stakeholders. Engagement opportunities are increasing with roadshows tied to higher volumes of thematic bond issuance, including social or sustainability bonds, particularly since the onset of the pandemic (see Figure 13). Governments such as Chile, Ecuador and Guatemala have issued social bonds that earmark proceeds for specific projects, such as support for low-income families, affordable housing and COVID-19 prevention, containment and mitigation.[20] Other countries, including South Korea and Slovenia, have issued sustainability bonds whose proceeds are in part used for social projects.[21]

Figure 13: Social and sustainable bond issuance by governments (US$bn). Sources: Moody's Investors Service, Climate Bonds Initiative, Dealogic, Environmental Finance Bond Database*



*No sovereigns issued social bonds in 2019.

16 See OHCHR (2012) Human Rights Indicators: A Guide to Measurement and Implementation.

17 See Jennifer Zerk and Rosie Beacock (2021) Advancing human rights through trade: Why stronger human rights monitoring is needed and how to make it work.

18 See The Conversation (March 2020) Lack of internet access in Southeast Asia poses challenges for students to study online amid COVID-19 pandemic.

19 See Inevitable Policy Response (2019) Why a just transition is crucial for effective climate action.

20 See Chile's Ministerio de Hacienda Social Bonds; Environmental Finance (March 2020) Social bond of the year, sovereign, and Award for innovation - bond structure (social): Republic of Ecuador; Environmental Finance Social bond of the year - sovereign: Republic of Guatemala.

21 See International Capital Markets Association Sustainable bonds database.

Collaborative engagement

Engaging alone with a sovereign state can raise the risk of political repercussions[22] or unwanted publicity. Sovereign bondholders can team up with other stakeholders to reduce these risks and enjoy the advantages of collaborative effort: sharing resources, maximising influence and addressing collective action problems. Potential collaborative partners include:

- **Other sovereign bondholders:** investor collaboration on deforestation[23] is a good example that could be replicated on human rights issues. One investor, CCLA, led an initiative involving engagement with the UK government and corporates on improving modern slavery legislation.[24]
- **Corporate investors:** some investors are actively engaging at the corporate level on human rights issues occurring within a country's borders. Recent examples include investors acting on concerns that relate to government policies in China and Myanmar.[25] There are also instances of investors engaging with companies to express concern over how facial recognition technology and data used to track immigrants could pose risks to human rights.[26] Finally, the Investor Alliance for Human Rights is also active in corporate engagement. Sovereign debt holders could take their cue from these initiatives and amplify their effects with a country-level approach.
- **Other stakeholders:** partnerships with non-governmental organisations could also prove a good way to call on governments to commit to specific human rights outcomes. The recent example of a joint call by Aviva and the World Wide Fund for Nature on the UK government to commit to a greener financial system ahead of COP26 is an example that could be replicated on human rights topics.[27]

Meanwhile, investors could also ask states to adhere to sanctions for human rights violations imposed on other countries.

STEP 3. ENABLING OR PROVIDING ACCESS TO REMEDY

States are expected to take steps to make sure that when business-related human rights abuses take place within their territory or jurisdiction, those affected have access to effective remedy, according to number 25 of the UNGPs. Remedy could involve apologies, financial or non-financial compensation or punitive sanctions. States can also implement measures or adopt policies to address a broader range of human rights issues.

Given their financial relationship with states, sovereign debt investors should use their voice to ensure the provision of access to remedy. Even if investors' influence is limited, they can still seek to initiate dialogue with policymakers and other stakeholders, when possible, through engagement, as described in the previous section.

While the UNGPs are focused on the realm of business, business is only one source of human rights abuses, which can also arise in ethnic, religious and other contexts. As such, sovereign debt investors can employ a broad focus in their engagement activities.

22 There are examples of political retaliation at the corporate level. For example, in 2021, some retailers faced boycotts in China or were excluded from retail platforms after they expressed concerns about human rights abuse. See Time (1 April 2021) Facing boycotts H&M and Nike are learning the new price of doing business with China; BBC (2 July 2021) H&M: Fashion giant sees China sales slump after Xinjiang boycott.

23 See Tropical Forest Alliance Investors Policy Dialogue on Deforestation (IPDD) Initiative.

24 See Capital Monitor (May 2021) Time to toughen up the UK's failing modern slavery policy.

25 See Responsible Investor (May 2021) Taking on China: How are responsible investors engaging with the powerhouse; IPE (May 2021) Denmark's P+ mulls divestment of 11 stocks linked to Myanmar military.

26 See Responsible Investor (June 2021) Thomson Reuters is Canada's canary in the coal mine for tech sector human rights risk; Candriam (7 June 2021) Facial recognition and human rights, what is the role of responsible investors and (10 June 2021) Investor Statement on Facial Recognition.

27 See Aviva (18 Jun 2021) Aviva joins forces with WWF.

CALL TO ACTION

The PRI recognises that signatories are at different stages of learning about and embedding human rights as a component of responsible investing. This paper aims to seed investors' understanding of how to frame human rights in investment decisions, with a focus on sovereign debt instruments. For investors ready to start this work, the PRI suggests the following:

Improve communication: better communication between investment managers, asset owners, investment consultants and beneficiaries could help elevate the consideration of human rights in investment decisions. This may require asset owners to better understand the implications of ethically driven choices for their investment universe. Investment managers should proactively flag human rights issues to asset owners, while asset owners should state their own preferences on how to deal with flagged items, alongside other ESG factors. Better communication with (and advice from) investment consultants could also prove helpful, either one-to-one or jointly with asset owners and investment managers.

Scale up engagement: where possible, investors should engage more with sovereign issuers, whether on an individual basis or collaboratively. Engagement with index providers is equally important: the more asset owners seek indices that reflect their investment objectives and requirements (including those related to human rights) the more index providers will create new indices that compete for adoption. We acknowledge though that investors may want to retain flexibility to judge countries on a case by case basis rather than mirror an index, especially when assessing trajectories and incorporating new data in valuations. ESG information providers could also broaden their product offerings if demand for data and services related to human rights increases.

Lend with strings attached: future lending, especially to fund the post-COVID recovery, could also be more conditional. This could happen at various stages, for instance by structuring debt issuance with features such as variable coupons, margin ratchets or covenants. These features could link to clear key performance indicators related to specific governance and social factors, including human rights. Additionally, sovereigns could be asked to redirect capital to certain sectors or to implement reforms when debt instruments need refinancing or in the event of debt restructuring.

Policy makers have signposted ways to incorporate ESG factors in sovereign finance more explicitly. The UN resolution on sovereign debt restructuring processes specifically mentions respect for human rights, among other factors.[28] The World Bank inserted significant policy conditionality into budget support programmes during the COVID-19 crisis.[29] Other stakeholders are reinforcing these efforts. For example, the Institute of International Finance is in the process of updating the [Principles for Stable Capital Flows and Fair Debt Restructuring](), including how best to consider ESG issues.[30]

As part of its multi-year plan for incorporating human rights into investment decisions, the PRI will continue to work on this topic and will solicit case studies highlighting best practice among investors who consider human rights issues in sovereign debt.

28 See UN General Assembly (10 September 2015) A/RES/69/319 article 1.8.

29 See Center for Global Development (8 July 2021) World Bank Budget Support in the Time of COVID: Crisis Finance...with Strings Attached.

30 The *Principles*, which were supported by the G20 in 2004, set out guidelines to support and encourage sustainable capital flows to emerging markets. The update, to be published ahead of the IMF/World Bank Spring Meetings in April 2022, will consider how best to incorporate ESG considerations more explicitly in the *Principles*, including in the context of engagement with creditors, commitment mechanisms, performance indicators and fiscal transparency.

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The Principles for Responsible Investment (PRI)

The PRI works with its international network of signatories to put the six Principles for Responsible Investment into practice. Its goals are to understand the investment implications of environmental, social and governance (ESG) issues and to support signatories in integrating these issues into investment and ownership decisions. The PRI acts in the long-term interests of its signatories, of the financial markets and economies in which they operate and ultimately of the environment and society as a whole.

The six Principles for Responsible Investment are a voluntary and aspirational set of investment principles that offer a menu of possible actions for incorporating ESG issues into investment practice. The Principles were developed by investors, for investors. In implementing them, signatories contribute to developing a more sustainable global financial system.

More information: www.unpri.org

The PRI is an investor initiative in partnership with UNEP Finance Initiative and the UN Global Compact.

United Nations Environment Programme Finance Initiative (UNEP FI)

UNEP FI is a unique partnership between the United Nations Environment Programme (UNEP) and the global financial sector. UNEP FI works closely with over 200 financial institutions that are signatories to the UNEP FI Statement on Sustainable Development, and a range of partner organisations, to develop and promote linkages between sustainability and financial performance. Through peer-to-peer networks, research and training, UNEP FI carries out its mission to identify, promote, and realise the adoption of best environmental and sustainability practice at all levels of financial institution operations.

More information: www.unepfi.org

United Nations Global Compact

The United Nations Global Compact is a call to companies everywhere to align their operations and strategies with ten universally accepted principles in the areas of human rights, labour, environment and anti-corruption, and to take action in support of UN goals and issues embodied in the Sustainable Development Goals. The UN Global Compact is a leadership platform for the development, implementation and disclosure of responsible corporate practices. Launched in 2000, it is the largest corporate sustainability initiative in the world, with more than 8,800 companies and 4,000 non-business signatories based in over 160 countries, and more than 80 Local Networks.

More information: www.unglobalcompact.org