A call for action to ensure strong regulation of the financial sector to avoid environmental, social and governance risks

JUNE 2017

Front cover image:
Charred termite mound in the remnants of homes burnt down by HAGL, Laos. March 2013. © Global Witness

EXECUTIVE SUMMARY

Across Africa, Latin America and Asia families are being forced off their land and rainforests razed to the ground – for projects backed by European money.

Companies looking for land to grow crops for industries, such as oil, gas or mining or for housing or infrastructure, rely on finance and loans from the financial institutions we in the European Union (EU) invest in. However, with few rules in place to regulate those institutions, there is little to stop them funding projects that are socially or environmentally damaging.

Global Witness, Friends of the Earth Europe (FoEE) and others are campaigning for Europe's financial regulations to be strengthened with robust Environmental, Social and Governance (ESG) safeguards, to stop investors from propping up companies that are grabbing land, abusing human rights and causing damage to the environment.

It is commonly believed that increased regulations will reduce European competitiveness and make financial sector institutions less profitable. This belief holds that companies can keep themselves in check when it comes to their social and environmental footprint. But the reality on the ground tells a very different story. EU-based investors are in fact putting themselves at significant financial and reputational risk by operating in regions where there are few guarantees, if any, that land has not been grabbed to make way for development.

The Capital Market Union (CMU) relaunch in September 2016 offers an ideal opportunity to ensure that the EU commits to fully integrating ESG factors into its financial regulation framework. Hailed as the final part of Europe's response to the financial crisis, the CMU is the EU's plan to develop different sources of finance to complement the banking system, to give savers more investment choices and offer businesses a greater choice of funding at lower costs.

It is our concern that without a strong regulatory framework this system risks making land-grabbing and environmental crime outside the EU even worse than it is currently by opening land and resources up to increased investment.

Other pieces of EU legislation currently regulating the financial sector at best contain only limited provisions relating to environmental and social concerns. This is the case for the Shareholders' Rights Directive, Institutions for Occupational Retirement Provision Directive, Non-Financial Reporting Directive, Prospectus Directive, Prospectus Regulation and the Packaged Retail and Insurance-based Investment Products Regulation. These are all reviewed in this briefing.

RECOMMENDATIONS

TRANSPARENCY

Legally binding requirements should be imposed on the financial industry and other companies to increase transparency.
This could include, but not necessarily be limited to:

- Develop an engagement policy with companies they invest in, which requires the latter to assess the ESG risks of financed projects and take steps to avoid those risks

- Publicly disclose, through the engagement policy as well as annual reporting systems, their exposure to ESG risks and how they are exercising due diligence to avoid such risks

- Ensure that information identifying investors in land is made known to the communities in the area and jurisdiction in which they are located, so that they know who to seek redress from. This should include announcing land investment in the area and signage around the land itself

- Provide information on guarantees that they have secured from companies that they do business with that they are proactively avoiding ESG risks.

ACCOUNTABILITY

Member states should:

- Ensure that financial sector institutions that do not exercise adequate ESG due diligence in any investment they promote will be held to account and liable to civil lawsuit or criminal prosecution

- Offer opportunities for individuals and communities, outside or within the EU, to seek redress in EU country courts in line with the United Nations (UN) Guiding Principles on Business and Human Rights that call on states to remove barriers to effective legal remedy.

DUE DILIGENCE

The financial industry and companies should:

- Undertake robust due diligence, which explicitly assesses the ESG risks of current and future land-tenure holdings and other investments

- Oblige issuers and intermediaries promoting investments in land-based projects to include in prospectuses a proof of "good title", to ensure that the land has not or will not be grabbed.

THE EU SHOULD:

- Support work within the UN Human Rights Council to adopt a binding treaty for businesses in relation to human rights, including considerations of the liabilities of both companies and financial investors for involvement in projects which violate such rights, as well as mechanisms for accountability and redress

- Refrain from promoting investment models that result in the large-scale transfer of tenure rights to investors, in line with Article 12(6) of the Voluntary Guidelines on the Responsible Governance of Tenure of Land, Fisheries and Forests in the Context of National Food Security (VGGT). Free, Prior and Informed Consent (FPIC) should also be secured from all affected communities, for all land and natural resource-based investments it supports through lending.

TOWARDS AN ESG DEFINITION

The ESG acronym has been open to various interpretations. We believe that ESG safeguards should relate to established international human rights law, including the instruments which make up the International Bill of Human Rights, subsequent UN human rights conventions, and the eight core International Labour Organization (ILO) conventions. The definition should also draw from developing soft law standards, the Paris Agreement and other binding international environmental standards seeking to prevent environmental destruction.

LIST OF ACRONYMS

AIF	Alternative Investment Fund
AIFMD	Alternative Investment Fund Managers Directive
CMU	Capital Markets Union
ESG	Environmental, Social and Governance
EU	European Union
FoE	Friends of the Earth
FOEE	Friends of the Earth Europe
FPIC	Free, Prior and Informed Consent
HAGL	Hoang Anh Gia Lai
ILO	International Labour Organisation
IORP II	Institutions for Occupational Retirement Provision Directive
ICAR	International Corporate Accountability Roundtable
MEPs	Members of the European Parliament
NGOs	Non-governmental organisations
PEF	Private Equity Fund
PRI	Principles for Responsible Investment
PRIIPs	Packaged Retail and Insurance-based Investment Products Regulation
SDGs	Sustainable Development Goals
STS	Simple transparent and standardised securitisations
UCITS	Undertakings for collective investment in transferable securities
UN	United Nations
VGGT	Voluntary Guidelines on the Responsible Governance of Tenure of Land, Fisheries and Forests in the Context of National Food Security
VRG	Vietnam Rubber Group

2017 – TIME FOR ACTION

At the global level land-grabs and deforestation, and the human rights violations, abuses, and corruption that facilitate them, are a major threat to the lives of communities. Land-grabs and deforestation often accompany the development of large-scale economic agro-industrial, extractive, infrastructure and other projects. These projects are receiving monies from powerful financial institutions. Many of these are based in the European Union (EU). Land-grabs and deforestation are among numerous negative Environmental, Social and Governance (ESG) harms, which often accompany financial institution investments.

Failing to adequately integrate and mainstream ESG factors in the EU financial regulations is counter-productive not only for the delivery of EU environmental and social policy objectives (including the United Nations (UN) Sustainable Development Goals (SDGs)[1] or the Paris Agreement[2]), but can also be negative for financial returns. Climate change has a direct impact on investments, especially in light of extreme weather conditions. Investors who do not consider climate risks in their portfolios may suffer losses because of assets stranded by climate change.

Global Witness and Friends of the Earth Europe (FoEE) have issued numerous reports documenting land-grabs and deforestation related to projects receiving investments channelled through EU-based financial sector institutions.[3] Globally, the UK, US, Germany, Netherlands and France consistently rank high among countries involved in large-scale overseas agribusiness investments.[4] At the beginning of 2015 for example, the top EU-based financial sector institutions (including banks, institutional investors and alternative investment funds) had provided nearly US$18 billion in outstanding loans and recent underwriting services to foreign agriculture companies based in developing countries.[5]

Global Witness and FoEE issued a report in November 2016 urging the development of a strong regulatory framework to ensure that the financial sector does not invest in land-grabs and deforestation and does not benefit from related human rights violations, abuses and corruption. Financial sector institutions and companies mainly rely on voluntary codes of conduct supposedly to ensure that they abide by corporate responsibility standards. But these codes have done little to prevent human rights abuses and violations, corruption and the land-grabs and deforestation that accompany them. What is required is a strong regulatory framework.[6]

The implementation of the EU's Capital Markets Union (CMU) Action Plan comprises new financial regulation initiatives and the review of financial regulation, which provide the EU with an opportunity to take decisive action. The European Commission's plans to accelerate implementation of the CMU announced in September 2016, together with the mid-term CMU review in 2017 by the European Commission, offer an ideal opportunity to ensure that the EU commits to fully integrating ESG factors in formulating its financial regulation framework. Full integration of ESG factors could give substance to the term 'sustainable finance'.[7]

Communities suffer the human rights and environmental impacts of projects that ignore ESG factors. Action to oblige the financial sector to actively avoid negative ESG impacts would be in line with the EU's international human rights obligations[8], the SDGs and the Paris Agreement. ESG impacts are not theoretical; they relate to real material environmental, human rights and social harms that can impact on companies – including those in the financial sector – in terms of legal, reputation and financial costs.

WEAK ESG PROVISIONS IN THE LEGAL FRAMEWORK

Current EU legislation does not oblige the financial sector to exercise due diligence to avoid negative ESG impacts. It contains few, if any, provisions to ensure that financial institutions can be held to account for failing to exercise such due diligence.

The EU should have in place a financial legal structure that prevents EU investment in projects which lead to negative ESG impacts, including land-grabs. It should be mandatory for financial institutions and companies to take action to avoid negative ESG impacts and for the avoidance of ESG risks to be factored into the development of all investment projects. Financial regulation adopted by the EU in the wake of the 2007-2008 financial crisis was supposedly designed to create greater financial stability and the CMU project was meant to ease the flow of capital throughout the EU. But this legal framework is seriously deficient when it comes to addressing ESG risk.

The next sections of this briefing highlight the deficiencies of the existing legal framework when it comes to obliging the financial industry to avoid negative ESG impacts.

Woman walking through rubber plantation – Shan state, Myanmar, November 2014. © Global Witness

They provide an overview of several key instruments (in elaboration or already approved) which include some or no ESG criteria: the Shareholders' Rights Directive, the Institutions for Occupational Retirement Provision Directive (IORP II), the Alternative Investment Fund Managers Directive (AIFMD), the Non-Financial Reporting Directive, the Prospectus Regulation and the Packaged Retail and Insurance-based Investment Products (PRIIPs) Regulation. The briefing also makes reference to other pieces of current and draft legislation regulating the financial industry, which is also failing to specifically oblige those promoting investment packages to take account of and avoid ESG risk.

a) Shareholders' Rights Directive[9]

What it is: The Shareholders' Rights Directive aims to strengthen the rights of shareholders in relation to companies registered in or trading in EU member states. Global Witness, FoEE and others have worked closely[10] with Members of the European Parliament (MEPs) to put forward[11] amendments to the regulation, which would require investors and asset managers to actively engage with their investee companies on social and environmental performance, and publicly disclose the results. Europe's asset management industry controls €17 trillion of assets,[12] so the Directive could result in far-reaching impacts if it encourages companies to adopt more responsible behaviour in ESG matters.

The Council of the EU explained that the new directive "will help institutional investors and asset managers to be more transparent as regards their approach to shareholder engagement. They will have to either develop and publicly disclose a policy on shareholder engagement or explain publicly why they have chosen not to do so."[13]

The positive language on ESG in the Directive:

(a) The Directive establishes that a remuneration policy "shall contribute to the company's business strategy and long-term interests and sustainability and shall explain how it does so" and that "It shall indicate the financial and non-financial performance criteria, including, where appropriate, criteria relating to corporate social responsibility…"[14]

It contains language calling on asset managers and institutional investors to:

(b) Publicly disclose their engagement policy which describes how they integrate shareholder engagement in their investment strategy: "The policy shall describe how they monitor investee companies on relevant matters, including strategy, financial and non-financial performance and risk, capital structure, social and environmental impact and corporate governance…"[15]

(c) Publicly disclose annually how their engagement policy has been implemented, providing information on how they voted in the general meetings of companies in which shares are held, an explanation of the "most significant votes" and "the use of the services of proxy advisors". [16]

The loopholes:

The Directive makes clear that the disclosure of ESG-related information is not compulsory and stipulates that institutional investors and asset managers can either comply with the two provisions outlined above or "publicly disclose a clear and reasoned explanation why they have chosen not to comply with one or more of these requirements."[17]

Furthermore, the Directive makes clear that in disclosing their engagement policy, institutional investors and asset managers can omit information on ESG impacts if they do not consider these to be "relevant matters"[18], in other words the wording of the Directive provides them with one possible reason not to comply. In relation to the submission of remuneration policy information to a company's annual meeting, a company is only obliged to provide information relating to corporate social responsibility "where appropriate"[19]. In other words, there is no real compulsion on institutional investors or asset managers to report on how they monitor investee companies in relation to ESG risk. Neither does the Directive impose obligations on companies to engage with stakeholders to avoid or minimise negative ESG impacts. While the legislation may encourage companies to voluntarily take ESG risks into account, the legislation does little to guarantee that communities will be protected from negative ESG harms, and provided with a right to redress.

b) The Institutions for Occupational Retirement Provision (Pension Funds) Directive[20]

What it is: Occupational pension funds otherwise known as "IORPs" (Institutions for Occupational Retirement Provision) are a form of employment-related retirement provision; alongside state social security pension schemes and voluntary supplementary retirement income, including those structured as life insurance, which are not at all covered by these rules. IORPs benefit from the principles of free movement of capital and free provision of services in the EU. This means, for example, that:

(i) pension funds can manage occupational pension schemes for companies established in another EU member state

(ii) pan-European companies can have a single pension fund for all their subsidiaries throughout the EU.

The rules governing the activities of IORPs in all EU countries are set out in Directive 2003/41/EC (the IORP Directive).[21] IORP seeks to make it easier for these schemes to operate across EU member states.

The IORP Directive has recently undergone revisions to improve governance standards in the sector for the first time since 2003. The revised Directive, IORP II came into force on 12 January 2017 and member states must introduce legislation to comply with the Directive by 13 January 2019.[22] IORPs hold assets worth €2.5 trillion on behalf of 75 million Europeans.[23]

The positive language on ESG in the Directive:

(a) Recital 58 alludes to ESG factors as referred to in the United Nations-supported Principles for Responsible Investment. To this extent the amended IORP II helps define ESG factors in such a manner that they can be understood to incorporate a broad range of environmental, human rights and governance issues.[24]

(b) The Directive requires member states to ensure that IORPs invest in accordance with the 'prudent person' rule and to ensure that they take account of the "the potential long-term impact of investment decisions on environmental, social, and governance factors."[25]

(c) IORPs are called upon to ensure that their system of governance takes into account ESG factors related to investment assets.[26]

(d) The text stipulates that member states should require IORPs possess a risk management system which could cover "environmental, social and governance risks relating to the investment portfolio and the management thereof."[27]

The loopholes:

However, the IORP II amended text contains some serious weaknesses. A series of loopholes in the text mean that there is no clear obligation on IORPs, at least not on all IORPs, to assess ESG risks in their investment, risk management and governance policies. IORPs are provided with ample room to determine for themselves if they should take ESG factors into account:

(i) Language in the text stipulates that member states are not obliged to apply most of the provisions of the Directive to pension schemes with less than 100 members.[28]

(ii) While language obliges an IORP to exercise the 'prudent person' rule, it is not an obligation to take ESG factors into account when applying this rule (member states must "allow" it).[29]

(iii) Text stipulating that member states should require IORPs to possess a risk management system which incorporates ESG considerations is qualified, the consideration of these risks are only to be taken into account "where applicable."[30]

(iv) Similarly, the text makes clear that provisions urging the IORP to factor in ESG into their governance policies are again discretional and consideration of these factors will be taken if they are deemed to "be proportionate to the size, nature, scale and complexity of the activities of the IORP."[31]

(v) The text only obliges IORPs to provide prospective members with information on "whether and how" it has considered ESG factors in their investment decisions.[32]

WILMAR INTERNATIONAL AND BUMITAMA AGRI LTD

In August and September 2015, fires in the forests and peatlands of Sumatra and Kalimantan caused 23 deaths (according to the national Human Rights Commission's report) and impacted 45 million people in Indonesia and neighbouring countries. On 14 October 2015 an estimated 61 megatons of greenhouse gases were released into the atmosphere, accounting for almost 97 per cent of Indonesia's total emissions that day. Indonesia's daily average emissions in 2012 were approximately 2.1 megatons.[33]

Research conducted by FoE groups into five palm oil plantations in Central Kalimantan that belong to Wilmar International and Bumitama Agri Ltd. showed that, despite the fact that these companies have adopted voluntary policies prohibiting burning, deforestation and exploitation of peatlands, they appear to have flouted national laws and their own voluntary guidelines. Therefore, violating the human right to health and to a healthy environment and allowing the destruction of high carbon stock areas, as well as taking insufficient measures to prevent forest fires in their plantations.

According to Article 49 of the national forest law no. 41/1999[34], companies are legally responsible for fires within their concessions, recognising that accountability and legal liability rest ultimately with the concession owners, in this case Wilmar and Bumitama.

However, in their responses to FoE, both companies blame other parties, such as local communities, or climatic factors such as winds spreading fires into concession areas. However, neither company provided evidence to support these statements.

Financiers in the UK, Netherlands, France, the United States[35] and other countries are providing direct financing to these companies – many of them doing so despite having publicly committed to ESG criteria that should prevent their financing such destructive activities. Of 11 financiers in the EU and 14 in the US to whom FoE has sent this report for comments, seven have responded by the time of publication. The answers FoE received ranged from: advice that FoE file a complaint with Wilmar itself or with the Roundtable on Sustainable Palm Oil (RSPO) – a multi-stakeholder body without a legal mandate and with a notorious time-lag in addressing complaints[36] – to a lengthy response arguing that Wilmar is in fact operating sustainably.

Despite detailed, independent, satellite-based and ground-checked evidence on specific cases, even financiers that have committed to upholding environmental standards do not seem alarmed by the lack of implementation of their own and their investee companies' policies during what many commentators are calling the largest environmental crisis of the 21st century.[37] Such a lax attitude bodes extremely ill for the efficacy of voluntary corporate commitments to social and environmental responsibility.[38]

(continued opposite)

Excavator on plantation in Central Kalimantan, Indonesia , September 2015 © Victor Barro/FoE

WILMAR INTERNATIONAL AND BUMITAMA AGRI LTD (continued)

This example shows that neither financiers, nor the companies they invest in, can necessarily be relied upon to regulate themselves. We need European legislators to take responsibility and establish regulation that will prevent EU financiers from providing financial services to companies which are engaged in land-grabbing, deforestation, burning or violations of human rights.

Person walking through plantation in Central Kalimantan, Indonesia, September 2015. © Victor Barro/FoE.

c) The Non-Financial Reporting Directive[39]

What it is: The Non-Financial Reporting Directive seeks to complement legislation which regulates the financial information that companies must make public. It ensures that they also provide shareholders and stakeholders with non-financial information so as to ensure that they have access to "a meaningful, comprehensive view of the position and performance of companies".[40]

The Directive was drafted under European Parliament pressure through two resolutions adopted on 6 February 2013: 'Corporate Social Responsibility: accountable, transparent and responsible business behaviour and sustainable growth'[41] and 'Corporate Social Responsibility: promoting society's interests and a route to sustainable and inclusive recovery.'[42] The European Parliament had: "acknowledged the importance of businesses divulging information on sustainability such as social and environmental factors, with a view to identifying sustainability risks and increasing investor and consumer trust. Indeed, disclosure of non-financial information is vital for managing change towards a sustainable global economy by combining long-term profitability with social justice and environmental protection."[43]

The positive language on ESG in the Directive:

The Directive obliges large companies to include in their management report information "relating to, as a minimum, environmental, social and employee matters, respect for human rights, anti-corruption and bribery matters."[44]

The Directive is more useful than any of the other regulations mentioned in this report, as its main objective is indeed to oblige companies, including investors, to disclose more information on their ESG impacts.

The loopholes:

Nevertheless, there are some loopholes in the Directive. If the undertaking employs less than 500 people it is exempt from the Directive, although member states might impose their own rules.[45] A company that "does not pursue policies in relation" to environmental, social and human rights matters, is not obliged to report on these issues although it should instead "provide a clear and reasoned explanation for not doing so."[46]

Companies are thereby given ample leeway not to report on ESG by arguing they have not developed a policy on the matter or alternatively simply by claiming that their business has no impact on these matters.

d) Alternative Investment Fund Managers Directive[47]

What it is: Alternative investment funds (AIFs) are mainly hedge funds, private equity funds (PEFs) and venture capital funds. The Alternative Investment Fund Managers Directive (AIFMD) operates by regulating managers of hedge funds and private equity funds, usually based within the EU, whilst the funds they manage are usually located in tax havens.[48] The AIFMD exists to regulate them via the companies who manage them. Private equity plays an important role in land grabs. According to a report by the Organisation for Economic Co-operation and Development, 44% of funds in farmland and agricultural infrastructure are derived from European private sector financiers.[49]

The positive language in the Directive:

(a) Language in the Directive relating to risk management obliges fund managers to exercise due diligence when investing: "according to the investment strategy, the objectives and risk profile" in the investment fund.[50]

(b) The Directive obliges fund managers to provide information on the "risk profiles" of the funds they are managing when applying for authorisation from competent authorities.[51]

(c) The Directive obliges fund managers to disclose to investors information on "the current risk profile of the AIF and the risk management systems employed by the AIFM to manage those risks."[52]

A villager rests in the shade of a felled tree inside a HAGL Economic Land Concession in Ratanakiri province, Cambodia. March 2013 © Global Witness

The loopholes:

The AIFMD was created in response to European Parliament calls for the development of specific regulation of hedge funds and PEFs in part to strengthen financial stability.[53] In line with these concerns the AIFMD only intends to curb financial systemic risk and address investor protection issues: "Recent difficulties in financial markets have underlined that many AIFM strategies are vulnerable to some or several important risks in relation to investors, other market participants and markets".[54]

It is therefore not a surprise that none of the provisions outlined in (a), (b) and (c) above make specific reference to ESG and so do not impose a specific obligation on alternative investment fund managers to take steps to:

(i) Exercise due diligence to avoid ESG risks when investing.[55]

(ii) To provide information on ESG risks when seeking authorisation from competent authorities.[56]

(iii) To disclose to investors the ESG risks that an AIF may face, nor disclose how the fund manager's risk management system avoids ESG risks.[57, 58]

The review of the AIFMD which will start by 22 July 2017 offers an important opportunity to ensure that wording in the legislation is clarified and ensure that investment fund managers are both obliged to report on ESG risks and how they have exercised due diligence to avoid ESG risk. The problem, however, is that the points to be addressed in the review do not specifically refer to ESG risk, and it would be essential that the Commission's mandate be amended so that it can consider amending the Directive in such a way that ESG risk considerations are fully incorporated.[59] Given the timing of the review, it is unrealistic to expect major legislative changes before the 2019 European elections and new Commission.

HOANG ANH GIA LAI (HAGL) AND VIETNAM RUBBER GROUP (VRG) IN CAMBODIA AND LAOS

In the past decade, both Cambodia and Laos have experienced a 'land grab' crisis. In Laos, due to the lack of transparency in the land sector, estimates for the amount of land leased out to private companies vary from 1.1 million to as much as 3.5 million hectares, with 18 per cent of villages in the country potentially affected.[60] Cambodia has seen as equally rapid sell-off, with 2.1 million hectares of land leased out as land concessions and at least 830,000 people impacted.[61]

In both countries, the land sector is dominated by secrecy and high levels of corruption. Business and political elites are seemingly able to get away with ignoring national laws designed to safeguard the rights of communities and the environment, and have been able to rely on state security forces to protect their private interests over those of ordinary citizens.

In its 2013 report "Rubber Barons",[62] Global Witness revealed how subsidiaries of two major Vietnamese rubber companies – HAGL and the VRG – acquired vast areas of land in violation of national laws in both Cambodia and Laos. In particular, the land lease purchases by both companies took place at the expense of local communities, which were barely compensated and whose free, prior and informed consent was not sought.

HAGL violated Cambodian law when it seized land without consulting villagers. For example, land grabs by HAGL in Ratanakiri Province in Cambodia severely damaged the livelihoods of 1,400 families from predominantly indigenous communities who lost both agricultural and forested land that they had relied upon for generations. These families received no or inadequate compensation for their losses.[63]

Additionally, Global Witness uncovered evidence that in Cambodia, HAGL's and VRG's activities had significant negative environmental impacts, including clearing of valuable and legally protected forests within their concessions and the chemical pollution of local water sources. Only after Global Witness had released its report on these land grabs and international pressure, including from investors, increased did the companies enter into a dialogue with the communities concerned.[64] Despite this engagement, very few of the affected individuals have received redress from the companies, although HAGL has at least begun a negotiation process with 14 Cambodian communities.[65]

In April 2013, HAGL wrote to Global Witness, denying all the allegations described above, including any involvement in illegal logging and taking land from local residents. Furthermore, the company stated that it was the responsibility of the governments of Cambodia and Laos to ensure that community land and forests were not included in concession areas. VRG declined to comment on evidence of its members and affiliates being responsible for land-grabbing and illegal activities in Cambodia and Laos. Instead, the company pointed to a set of

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HOANG ANH GIA LAI (HAGL) AND VIETNAM RUBBER GROUP (VRG) IN CAMBODIA AND LAOS (continued)

"responsible investment principles" that it adheres to, which include observing national laws, respecting the welfare of local communities, and implementing social infrastructure projects.[66]

In "Rubber Barons" Global Witness published evidence that the German banking giant Deutsche Bank was a source of finance for VRG and HAGL and on 13 November 2013 Global Witness called on backers to withdraw from investments in HAGL.[67] Six days later Global Witness learnt that Deutsche Bank no longer held significant stocks in the company. The Bank did not confirm whether this withdrawal was prompted by Global Witness' call.[68]

However, Deutsche Bank has maintained a reduced interest in HAGL through Deutsche Asset Management Americas, part of the Deutsche Bank Group, holding 1.64% of HAGLs shares. Whilst the holding may be small it is of concern that the Deutsche Bank Group has maintained its relationship with HAGL. In a letter to Deutsche Asset Management Americas of 27 March 2017, Global Witness expressed its concern that the company had either failed to conduct sufficient due diligence before investing in HAGL, or chose to ignore widespread reports that HAGL's portfolio included failures to comply with national laws in countries of operation and business activities that have caused environmental damage and significant harms to the local population amounting to human rights violations. To date no response has been received.

Global Witness also wrote to HAGL on the same date. The company replied on 5 April suggesting that the size of rubber plantations held by three subsidiaries in Ratanakiri Province was smaller than that alleged previously by Global Witness. The company also stated that since 2015 it had been involved in a dispute resolution process with several communities, coordinated by the World Bank Group.

Had EU financial regulation been in place to prevent investors financing projects on land grabbed from local people, the chances of Deutsche Bank funds underwriting the HAGL project would have been greatly diminished.

e) Prospectus Directive[69] and Prospectus Regulation[70]

What it is: The Prospectus Regulation, which will replace the Prospectus Directive by mid-2019, establishes the information companies must provide in prospectus documents to enable investors to make decisions on investments.

The Prospectus Directive came into force on 31 December 2003 through its publication in the EU Official Journal. As part of the CMU Action Plan the European Commission proposed a reform of the rules that allow companies to raise money on public markets or through a public offer with investors on 30 November 2015: "The prospectus rules proposed today will enable investors to make informed investment decisions, simplify the rules for companies that wish to issue shares or debt and foster cross-border investments in the single market. This is also an important measure in order to improve the regulatory environment for investments in the EU, as announced in the Investment Plan for Europe."[71]

The positive language in the Directive, retained in the new Regulation:

(a) The legislation obliges the issuer of the securities to include in a prospectus information relating to risks associated with the securities offered.[72]

(b) The legislation empowers competent authorities to "require the issuer to disclose all material information which may have an effect on the assessment of the securities admitted to trading on regulated markets in order to ensure investor protection or the smooth operation of the market;…"[73]

The new positive language in the Regulation:

The Regulation specifies that "environmental, social and governance circumstances can also constitute specific and material risks for the issuer and its securities and, in that case, should be disclosed".[74]

The prospectus must include risk factors relevant for an investor[75], potentially including ESG-related risk.

The loopholes:

The Directive does not specify obligations to companies to report on how they avoid ESG risks: neither of the provisions referred to in (a) and (b) above specify that the information required should include material relating to ESG risks identified by issuers and action taken to avoid ESG risk.

The Regulation widens the existing exemption excluding certain companies from the obligation of providing a prospectus if the total value of securities offered is "less than EUR 1,000,000, which shall be calculated over a period of 12 months."[76]

In the new Regulation, the only direct reference to ESG risk (quoted above) is in a recital, which gives it less legal value. It remains to be seen whether national supervisors will pay attention to this provision in the process of authorizing prospectuses.

The generic requirement to disclose relevant risk factors is limited to "risks which are specific to the issuer and/or to the securities and are material for taking an informed investment decision"[77] and as such might not include general risks arising from negative ESG impacts, if they do not disproportionately impact the issuer in question. On the other hand, the Commission is tasked to develop delegated regulation to further specify "criteria for the assessment by the issuer of the specificity and materiality of risk factors and for the presentation of risk factors across categories depending on their nature."[78, 79]

f) Key information documents (KIDs) for packaged retail and insurance-based investment products (PRIIPs) Regulation (EU) No 1286/2014 of 26 November 2014 – Legislation applies from 1 January 2018[80]

What it is: PRIIPs are types of financial products which can be sold to retail investors.[81] The Regulation obliges distributors of such products to provide KIDs, which are drafted by banks and insurance companies issuing those products. The rules only cover packaged products, excluding "simple" insurance and investment products such as shares and life insurance.[82]

The positive language in the Regulation:

(a) The Regulation states that the KID should include any "specific environmental or social objectives targeted by the product".[83]

(b) The Regulation contains a provision empowering the Commission to adopt delegated acts detailing the procedures to be used to establish whether a PRIIP targets specific environmental or social objectives.[84]

The loopholes:

(i) Language in the text, which empowers the Commission to develop procedures to determine whether a PRIIP targets specific environmental and social objectives, underlines the fact that there is no obligation whatsoever on PRIIPs to take ESG risks into account.[85]

(ii) The text states that the Commission should review this Regulation by 31

December 2018 (but we understand that the review is being delayed) taking account of the "costs and possible benefits of introducing a label for social and environmental investments".[86] This provision again suggests that while PRIIPs, which take into account ESG factors, will be "rewarded" with a label, it makes clear that avoidance of ESG risk in PRIIPs is not compulsory.

(iii) While the text specifies that the KIDs include information on "environmental or social objectives" this is not compulsory and the text makes it clear that this is only "where applicable".[87]

(iv) The Regulation calls on the Commission to specify "criteria and factors" to be used by the authorities "in determining when there is a significant investor protection concern or threat" and on that basis to take a decision to prohibit or restrict the marketing or sale of insurance-based investment products.[88] But the language in the Regulation does not specify or make clear that ESG risk factors would be among those criteria used to order a prohibition or restriction of the sale or marketing of such financial products.[89]

g) Other legislation relating to the finance industry

The EU has introduced a raft of other legislative measures to encourage the development of the EU financial industry, which it has presented as designed to increase the stability of the financial sector. A review of some of these pieces of legislation reveals that the EU has not imposed an obligation on the finance industry to factor in and avoid ESG risk:

Capital Requirements Regulation and Directive[90] – this legislation implements the international "Basel III" package in the EU and seeks to ensure that credit institutions (banks) maintain sufficient reserves to avoid financial collapse as a result of exposure to risk. Neither the Directive nor Regulation contains language specifying that financial institutions take action to avoid ESG risks.

The Financial Stability Board's Task Force on Climate-Related Financial Disclosures[91] on 14 December 2016 published its recommendations for climate risk disclosure. This project is targeted at one form of environmental risk and focuses on disclosure only, hence its potential legislative impact on the Basel framework and bank capital rules in the EU will be limited.

Simple Transparent and Standardised Securitisations Regulations[92] – In September 2015 the Commission adopted two legislative proposals governing the development of "simple transparent and standardised" (STS) securitisations, one a new regulation and the other a proposal to amend the Capital Requirements Regulation. The package seeks to encourage securitisations including, by lowering capital requirements for certain instruments that according to the Commission have a reduced financial stability risk. In its press release of 14 September 2016, the European Commission stated that the "swift implementation" of the STS regulation would be one of the first measures it would complete under its CMU Action Plan. In the STS legislative file[93] entering in trilogue stage, the European Parliament has introduced an amendment[94] for securitisations benefitting from favourable STS treatment. If accepted, it could at least encourage the originator and sponsors of STS securitisations to take some account of ESG risks when developing these instruments: "The originator and the sponsor shall publish information on the long-term, sustainable nature of the securitisation for the investors, using ESG criteria to describe how the securitisation contributed to real economy investments and in which way the original lender used the freed-up capital."[95]

Undertakings for collective investment in transferable securities (UCITS)[96] – Directive

2014/91 –regulates "undertakings for the collective investment in transferable securities" (UCITS), which are investment funds regulated at EU level. The Directive does not contain provisions specifically obliging managers of UCITS to avoid ESG risks, although some complex UCITS products will be covered by PRIIPs once the five-year transition period ends. There might, however, be an opportunity in the medium-term to align the remaining UCITS products to the PRIIPs rules, which would at least ensure some consideration of environmental and social matters are undertaken in line with the PRIIPs Regulation.

CONCLUSIONS AND GENERAL RECOMMENDATIONS FOR AN OVERARCHING PIECE OF LEGISLATION AS PART OF THE CMU REVIEW

Global Witness and FoEE are concerned that the legislative architecture regulating the financial industry contains hardly any binding obligation to factor in ESG criteria into the development of investments. Failure to exercise due diligence in ESG can translate into serious negative impacts on the environment, including deforestation, human rights abuses and violations of the right to life, and land grabs at the local and global level.

As financial sector institutions are given ample leeway to define what they consider to be risks, they are all too often free or relatively free to ignore ESG risks. In some cases ESG harms provide a means to bring down the costs of investments and so often it is convenient to not define them as risks. The challenge is to ensure that a strong regulatory framework is developed to oblige the financial industry to acknowledge these as risks. This should also ensure that financial institutions are liable to pay for harms caused, face legal civil or criminal proceedings arising from ESG harms and bear the full force of reputational damage costs of such negative impacts.

TOWARDS A DEFINITION OF ESG

The use of the ESG acronym has been open to various interpretations, but we consider that core ESG risks relate to established international human rights law including: the core rights and duties laid out in the instruments which make up the International Bill of Human Rights, subsequent UN human rights conventions,[97] and the eight core International Labour Organisation (ILO) conventions.[98] The definition of ESG risks should also draw from developing soft-law standards that are heavily based on the binding treaties which make up the International Human Rights Bill and additional human rights conventions including: the UN Guiding Principles of Business and Human Rights,[99] the Voluntary Guidelines on the Responsible Governance of Tenure of Land, Fisheries and Forests in the Context of National Food Security (VGGT),[100] the UN SDGs, the Principles on Responsible Agricultural Investment [101] and the UN-supported Principles of Responsible Investment, which itself includes a definition of ESG.[102] Furthermore, the definition should also draw from the Paris Agreement and other binding international environmental standards seeking to prevent environmental destruction.[103, 104]

DEVELOPING A STRONG LEGAL UMBRELLA FRAMEWORK

It is essential that controls be enacted, and enforced, to ensure that funds allocated through investment instruments outside the EU do not support any investment that instigates or benefits from human rights violations and abuses, including those leading to land-grabbing and deforestation and other negative ESG impacts. These controls should apply to, but not be limited to, investments in jurisdictions where there is weak rule of law. In such jurisdictions there may be little if any guarantee that investments will not result in negative environmental and social impacts spurred on by corruption, a lack of political will to end impunity in cases of human rights violations and abuses, or the promotion of legislation and policies by host states which weaken or undermine Free, Prior and Informed Consent (FPIC) rights or otherwise facilitate land-grabbing.

Such reform would oblige the manager or promoter of an investment instrument to exercise due diligence to actively avoid permitting investments in these contexts. Reform should also ensure that any investment instrument should not be authorized in economic projects that support illegal logging or armed conflicts and thereby undermine the EU's Forest Law Enforcement Governance and Trade (FLEGT) Action Plan and EU Timber Regulation and the EU Conflict Minerals Regulation.

Regulation of the financial sector is covered by numerous pieces of legislation subject to review in a staggered timeframe; this means that to enact and enforce such controls would be a lengthy process. For this reason we consider that an overarching legislative measure should be implemented.

A strong regulatory framework should be built on the basis of the principles of Transparency; Accountability and Due Diligence:

Transparency: An obligation on a financial investment concern to publish clear and full information on any potential ESG risks involved in any investment strategy and what due diligence measures have been exercised by the issuers and offerors to avoid, identify, prevent, mitigate and account for[105] negative ESG impacts in any investment they promote.

Accountability: Language which ensures that financial sector institutions that do not exercise adequate due diligence to avoid negative ESG impacts in any investment they promote should be held to account and as appropriate liable to civil lawsuit or criminal prosecution. Financial sector institutions should be held to account for failing to provide full and accurate information on potential ESG risks related to the investment packages they are marketing.

Member states should offer opportunities for individuals and communities, outside or within the EU, to seek redress in EU country courts in line with the UN Guiding Principles on Business and Human Rights that call on states to remove barriers to effective legal remedy.[106] One way of achieving this may be through efforts to build on the Brussels I Regulation and the Rome II Regulation.

The Brussels I Regulation allows civil liability cases to be brought before EU member state courts even if the subject of the claim was committed outside the EU. The Rome II Regulation in most cases would oblige courts to apply the law of the state in which the harm was committed. This may be problematic if the local law does not provide sufficient redress for the harms caused. The Rome II Regulation allows for some exceptions to the rule that host state law should be applied.[107] Accordingly victims of environmental destruction may request a court to apply the law "in which the event giving rise to the damage occurred" as opposed to the law of the country where the damage occurred.[108] It would be important to expand this provision to ensure that the victims of human rights violations may likewise elect which law should be applied.[109]

Since some of the ESG impacts may be criminal in nature the EU should also facilitate bringing criminal cases to courts in the EU where victims have not secured redress or are unlikely to secure redress. That the international financial and other economic sectors should be faced with the criminal consequences of failing to take action to avoid or draw benefit from negative ESG impacts is highlighted by recent decisions at the level of the International Criminal Court.

(See box below.)

Due diligence: An obligation should be imposed on issuers and intermediaries promoting investments in projects seeking access to land to include in prospectuses a proof of "good title", to ensure that the land is not subject to potential land grab or has already been subject to land grab. Proof of "good title" can be secured, at least to some extent, through consultation with affected communities, consultation of land registry documents (in areas where falsification of land registry documents is not a problem), UN agencies and other intergovernmental agencies and non-governmental organisations (NGOs) operating in the region. Financial sector institutions should be obliged to provide information on the guarantees they have secured from companies with which they maintain commercial relations that they will not get involved in land grabs.

Financial sector institutions must be obliged to exercise due diligence to avoid ESG harms – including by not contributing, exacerbating, causing or operating in a manner which benefits from ESG harms by design or through omission, as well as through action to identify, prevent, mitigate and account for them. They should also demonstrate how they exercise precaution and avoid investing in any company implicated or accused in possible land grab cases featured in UN, NGO reports, criminal prosecutions or civil lawsuits, whether or not in the same areas in which their planned investments are targeted.

The International Criminal Court decision to investigate international crimes associated with land-grabbing and destruction of the environment

On 15 September 2016 the Office of the Prosecutor of the International Criminal Court announced that it would give "particular consideration to prosecuting Rome Statute crimes that are committed by means of, or that result in, inter alia, the destruction of the environment, the illegal exploitation of natural resources or the illegal dispossession of land." In effect executives in the financial and other industries could now be held criminally responsible under international law for crimes linked to land-grabbing and environmental destruction.

RECOMMENDATIONS

Bearing the above in mind and building on recommendations included in the FoEE and Global Witness joint report of November 2016 and other reports a strengthened legal framework should include inter alia:

Transparency

Legally binding requirements should be imposed on the financial industry and other companies to increase transparency. This could include, but not necessarily be limited to:

- Develop an engagement policy with companies they invest in which requires the latter to assess the ESG risks of financed projects and take steps to avoid those risks
- Publicly disclose, through the engagement policy as well as annual reporting systems, their exposure to ESG risks and how they are exercising due diligence to avoid such risks
- Ensure that information identifying investors in the land is made known to the communities in the area and jurisdiction in which they are located so that they know who to seek redress from. This should include announcing land investment in the area and signage around the land itself
- Provide information on guarantees that they have secured from companies that they do business with that they are proactively avoiding ESG risks.

Accountability

Member states should:

- Ensure that financial sector institutions that do not exercise adequate ESG due diligence in any investment they promote will be held to account and liable to civil lawsuit or criminal prosecution
- Offer opportunities for individuals and communities, outside or within the EU, to seek redress in EU country courts in line with the UN Guiding Principles on Business and Human Rights that call on states to remove barriers to effective legal remedy.

Due diligence

The financial industry and companies should:

- Undertake robust due diligence, which explicitly assesses the ESG risks of current and future land-tenure holdings and other investments
- Oblige issuers and intermediaries promoting investments in land-based projects to include in prospectuses a proof of “good title”, to ensure that the land has not or will not be grabbed.

The EU should

- Support work within the UN Human Rights Council to adopt a binding treaty for businesses in relation to human rights, including considerations of the liabilities of both companies and financial investors for involvement in projects which violate such rights, as well as mechanisms for accountability and redress
- Refrain from promoting investment models that result in the large-scale transfer of tenure rights to investors, in line with Article 12(6) of the VGGT. FPIC should also be secured from all affected communities, for all land and natural resource-based investments it supports through lending.

ENDNOTES

1 United Nations, "Sustainable Development Goals. 17 Goals to Transform Our World" available at: http://www.un.org/sustainabledevelopment/ The EU has stated its commitment to the SDGs, see for example: European Commission: "European Commission welcomes new 2030 United Nations Agenda for Sustainable Development" (25 September 2015) available at: http://europa.eu/rapid/press-release_IP-15-5708_en.htm

2 Paris Agreement (adopted 12 December 2015, entered into force on 4 November 2016) UNTS Volume number not available at the time of writing. The Agreement builds on the United Nations Framework Convention on Climate Change and came into force on 4 November 2016, it was ratified by the EU in 2016. The Agreement is available at: http://unfccc.int/paris_agreement/items/9485.php

3 For example, see reports: FoEE, "Up in Smoke: Failures in Wilmar's promise to clean up the palm oil business" (2015) available at: http://foeeurope.org/sites/default/files/corporate_accountability/2015/07_foee_wilmar_report_mr_0_0.pdf and Global Witness, "Rubber Barons. How Vietnamese companies and international financiers are driving a land-grabbing crisis in Cambodia and Laos" (2013) available at: https://www.globalwitness.org/en/campaigns/land-deals/rubberbarons/ Also see case studies in boxes.

4 Deutsche Bank, "Foreign investment in farmland. No low-hanging fruit" (2012) available at: https://www.dbresearch.com/PROD/DBR_INTERNET_EN-PROD/PROD0000000000296807/Foreign+investment+in+farmland%3A+No+low-hanging+fruit.pdf

5 Fern, "Clear Cut: Making EU financial institutions work for people and forests" (2015) available at: http://www.fern.org/clearcut

6 These arguments are laid out in the report: FoEE and Global Witness, "Regulating Risk. Why European investors must be regulated to prevent land-grabs, human rights abuses and deforestation" (2016) available at: https://www.globalwitness.org/en-gb/reports/regulating-risk/

7 European Commission, "State of the Union 2016: Completing the Capital Markets Union – Commission accelerates reform" (14 September 2016) press release available at: http://europa.eu/rapid/press-release_IP-16-3001_en.htm As part of the Action Plan the Commission announced the creation of a High-Level Expert Group to develop a sustainable finance strategy: European Commission, "Commission Decision of 28.10.2016 on the creation of a High-Level Expert Group on Sustainable Finance in the context of the Capital Markets Union" C(2016) 6912 final. The terms of reference calling for applicants to the group contained no reference to social and governance risks, suggesting that the Commission intended the main focus of the work of this group to be on climate risk. As the work of the group progresses – it started meeting in January 2017–we trust that all three components of ESG will be examined to provide the concept of 'sustainable finance' with substance.

8 The EU has laid out its commitments to human rights in: Council of the European Union, "Council Conclusions on the Action Plan on Human Rights and Democracy 2015 – 2019" 10896/15, (2015) available at: http://data.consilium.europa.eu/doc/document/ST-10897-2015-INIT/en/pdf Article 21 paras (1) and (3) of the Consolidated Version of the Treaty on European Union [2016] OJ C202/13 make clear that the protection of human rights shall be pursued in the development of its external affairs.

9 Council Directive of 23 March 2017 amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement [2017], 2014/0121 (COD). (Shareholder Rights Directive).

10 Anne van Schaik and Megan MacInnes, "EU votes on shareholder measures to tackle reckless companies" (4 June 2015) available at: http://www.euractiv.com/sections/social-europe-jobs/eu-votes-shareholder-measures-tackle-reckless-companies-315057 and WWF, FoEE, Action Aid, ShareAction, E3G, Global Witness, "Shareholder Rights Directive" (2016) available at: https://shareaction.org/wp-content/uploads/2016/11/PolicyBriefing-ShareholderRights.pdf

11 ShareAction and Global Witness, "European Shareholder Rights Directive Takes Steps to Curb Corporate Excesses, But Governance Gaps Remain" (7 July 2015) available at: https://www.globalwitness.org/en-gb/press-releases/european-shareholder-rights-directive-takes-steps-curb-corporate-excesses-governance-gaps-remain/

12 European Commission Green Paper, "Building a Capital Markets Union", COM(2015) 63 final, available at http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52015DC0063

13 Council of the EU, "Shareholders' rights in EU companies: Presidency strikes deal with Parliament" [Press Release, 738/16, 16 December 2016] available at http://www.consilium.europa.eu/press-releases-pdf/2016/12/47244651774_en.pdf

14 Shareholder Rights Directive Article 9a(6).

15 ibid Article 3g(1)(a).

16 ibid Article 3g(1)(b).

17 ibid Article 3g(1).

18 ibid Article 3g(1)(a).

19 ibid Article 9a(6).

20 Council Directive (EU) 2016/2341 of 14 December 2016 on the activities and supervision of institutions for occupational retirement provision (recast), [2016] OJ L 354,/37. (IORPD).

21 European Commission, "Occupational pension funds" [nd] available at: https://ec.europa.eu/info/business-economy-euro/banking-and-finance/insurance-and-pensions/occupational-pension-funds_en

22 Pensions Europe, "IORP II Directive" (nd) available at: http://www.pensionseurope.eu/iorp-ii-directive

23 European Parliament,"Occupational pensions. Revision of the Institutions for Occupational Retirement Provision Directive (IORP II)" [Briefing EU Legislation in Progress, January 2017] available at: http://www.europarl.europa.eu/RegData/etudes/BRIE/2017/595899/EPRS_BRI(2017)595899_EN.pdf

24 IORP Recital 58.

25 ibid Article 19(1)(b).

26 ibid Article 21(1).

27 ibid Article 25(2).

28 ibid Article 5.

29 ibid Article 19(1)(b).

30 ibid Article 25(2)(g) and 25(2).

31 ibid Article 21(2).

32 ibid Article 41(1)(c).

33 Bloomberg, "How Indonesia's Fires Made it the Biggest Climate Polluter" 28 October 2015 available at: https://www.bloomberg.com/news/articles/2015-10-28/how-indonesia-s-fires-made-it-the-biggest-climate-polluter

34 Law of the Republic of Indonesia Number 41 of 1999 Regarding Forestry. Article 49: "Title or permit holders shall be responsible for any forest fire occurring to their working areas."

35 Such as Rabobank, ING, PGGM, HSBC, ABN AMRO, Blackrock, BNP Paribas, Crédit Agricole, JPMorgan Chase

36 Environmental Investigation Agency and Grassroots, "Who Watches the Watchmen: Auditors and the breakdown of oversight in the RSPO" November 2015 available at: https://eia-international.org/wp-content/uploads/EIA-Who-Watches-the-Watchmen-FINAL.pdf

37 Among other sources see Erik Meijaard, "Indonesia's Fire Crisis – The Biggest Environmental Crime of the 21st Century" Jakarta Globe 23 October 2015 available at: http://jakartaglobe.beritasatu.com/opinion/erik-meijaard-indonesias-fire-crisis-biggest-environmental-crime-21st-century/; Allan Nairn, "Massive Indonesian Plantation Fires Create Environmental Catastrophe Spewing Haze & Carbon Emissions" Democracy Now 27 October 2015 available at: http://www.democracynow.org/2015/10/27/massive_indonesian_plantation_fires_create_environmental; Enca.com, "Indonesia forest fires: warships put on standby" Enca.com 24 October 2015 available at: https://www.enca.com/world/indonesia-forest-fires-warships-put-standby

38 FoEE, Up in Smoke.

39 Council Directive 2014/95/EU of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups [2014] OJ L 330/1. (Non-Financial Reporting Directive).

40 European Commission, "Non-Financial Reporting" available at: http://ec.europa.eu/finance/company-reporting/non-financial_reporting/index_en.htm

41 European Parliament, "European Parliament resolution of 6 February 2013 on corporate social responsibility: accountable, transparent and responsible business behaviour and sustainable growth" [2012/2098(INI)] available at: http://www.europarl.europa.eu/sides/getDoc.do?type=TA&reference=P7-TA-2013-0049&language=EN&ring=A7-2013-0017

42 European Parliament, "European Parliament resolution of 6 February 2013 on Corporate Social Responsibility: promoting society's interests and a route to sustainable and inclusive recovery" [2012/2097(INI)] available at: http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+TA+P7-TA-2013-0050+0+DOC+XML+V0//EN&language=EN

43 Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014 amending Directive 2013/34/EU [2014] OJ L 330/1. (Non-Financial Reporting Directive).

44 Non-Financial Reporting Directive Article 1 introducing a new article 19a in Directive 2013/34/EU (Article 19(a)(1)).

45 ibid Article 1 introducing a new article 19a in Directive 2013/34/EU (Article 19(a)(1))

46 ibid Article 1 introducing a new article 19a in Directive 2013/34/EU. (Article 19(a)(1)).

47 Council Directive 2011/61/ 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010 [2011] OJ L 174/1. (AIFMD).

48 Jay Cullen, Andrew Johnston, Paige Morrow, Ting Xu, 'European Financial Regulation and Land Grabbing: Legal Analysis and Policy Recommendations', Written for Global Witness and FoEE, (January 2016), (University of Sheffield, Frank Bold).

49 HighQuest Partners, United States (2010), "Private Financial Sector Investment in Farmland and Agricultural Infrastructure", OECD Food, Agriculture and Fisheries Papers, No. 33, OECD Publishing, Paris.
DOI: http://dx.doi.org/10.1787/5km7nzpjlr8v-en

50 AIFMD Article 15(3)(a).

51 ibid Article 7(3)(a).

52 ibid Article 23(4)(c).

53 European Parliament, "European Parliament resolution of 23 September 2008 with recommendations to the Commission on hedge funds and private equity" (2007/2238(INI)) "… financial stability also requires better supervisory cooperation, including at global level, which logically requires, continuing improvements of current EU supervisory arrangements including regular exchanges of information and enhanced transparency of institutional investors", available at: http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+TA+P6-TA-2008-0425+0+DOC+XML+V0//EN#BKMD-16

54 AIFMD Recital 3.

55 ibid Article 15(3)(a) The language in the Directive obliges a fund manager "to implement an appropriate, documented and regularly updated due diligence process when investing on behalf of the AIF, according to the investment strategy, the objectives and risk profile of the AIF" but this language does not make clear that due diligence incorporates action to avoid ESG risk.

56 ibid Article 7(3)(a). The reference to risk profiles in this article does not specify that this includes ESG risk.

57 ibid Article 23(4)(c). In referring to the risk profiles and the risk management system employed by a fund manager no specific reference is made to make clear this should include matters relating to ESG risk.

58 EU definition of what is meant by a "risk profile" leads to Commission Delegated Regulation (EU) No. 231/2013 of 19 December 2012 supplementing Directive 2011/61/EU of the European Parliament and of the Council with regard to exemptions, general operating conditions, depositaries, leverage, transparency and supervision [201] OJ L 83/1 which specifies that the risk profile must be in keeping with risk limits laid out in Article 44(2) of Article 44 provides a list of risks that primarily focus on those relating to threats to financial stability, with the exception of "operational risks". Recital 65 of the Regulation makes clear that the interpretation of "the terminology is used consistently in both legal acts, therefore the definitions given in Directive 2006/48/EC are taken as

reference". Article 4(22) of Council Directive 2006/48/EC of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions (recast) [2006] OJ L 177/1, defines operational risk as the "loss resulting from inadequate or failed internal processes, people and systems or from external events, and includes legal risk". ESG risks could fall into this category but Annex V (9) of this Directive states "credit institutions shall articulate what constitutes operational risk". In other words ample leeway is provided to the undertaking to articulate what constitutes operational risk and so there is potentially ample room not to identify ESG risks as an operational risk.

59 AIFMD Article 69(4) states that the Commission should take into account "effects on investor protection, market disruption and competition, the monitoring of systemic risk and potential impacts on investors."

60 Miles Kenney-Lazar, "Plantation rubber, land grabbing and social property transformation in Southern Laos", 39 J. of Peasant Studies n.3-4 1023 (2012); Karen McAllister, "Rubber, Rights and Resistance: the evolution of local struggles against a Chinese rubber concession in Northern Laos, International Conference on Global Land Grabbing II, 3" (2012); Michael Epprecht, et. al., "Concessions and Leases in Lao PDR: Taking stock of land investments 9", 75 (2006), available at: https://www.researchgate.net/publication/257780558_Concessions_and_Leases_in_the_Lao_PDR_Taking_Stock_of_Land_Investments ; Land Issues Working Group (LIWG), "Managing Land, Forest, and Natural Resources. Growing in Equity or Growing Inequity" (2012) available at http://laocs-kis.org/wp-content/uploads/2015/02/Introduction-to-Lao-Land-Issues-2012-ENG-final.pdf

61 LICADHO, "Cambodia's Concessions" available at: http://www.licadho-cambodia.org/land_concessions/ ; FIDH, "Cambodia: 60,000 new victims of government land-grabbing policy since January 2014" 22 July 2015 available at: https://www.fidh.org/en/region/asia/cambodia/cambodia-60-000-new-victims-of-government-land-grabbing-policy-since

62 Global Witness, Rubber Barons.

63 ibid

64 ibid

65 Global Witness personal communications (2016). In preparing this report, the International Corporate Accountability Roundtable (ICAR) attempted to contact both HAGL and VRG for responses to the allegations contained herein. No response was received from either company by the time of this report's publication.

66 This text is largely copied from the Tainted Lands report published by ICAR and Global Witness in 2016. ICAR wrote to HAGL and VRG for a response on the allegations in this text, but no response was received.

67 'Global Witness calls for investors to drop Vietnamese rubber giant HAGL over failure to reform on land grabs', Global Witness press release 13 November 2013 available at: https://www.globalwitness.org/en-gb/archive/global-witness-calls-investors-drop-vietnamese-rubber-giant-hagl-over-failure-reform-land/

68 'Deutsche Bank divests from Vietnamese land grabber HAGL following Global Witness' Expose', Global Witness press release 29 November 2013 available at: https://www.globalwitness.org/en-gb/archive/deutsche-bank-divests-vietnamese-land-grabber-hagl-following-global-witness-expose/

69 Council Directive 2003/71/EC of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC [2003] OJ L 345/64. (Prospectus Directive).

70 Position of the European Parliament adopted at first reading on 5 April 2017 with a view to the adoption of Regulation (EU) 2017/... of the European Parliament and of the Council on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market, and repealing Directive 2003/71/EC available at: http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+TA+P8-TA-2017-0110+0+DOC+XML+V0//EN&language=EN#top The Prospectus Regulation was approved by the European Parliament on 5 April 2017 and at the time of writing awaits final adoption by the Council. (Prospectus Regulation).

71 European Commission press release http://europa.eu/rapid/press-release_IP-15-6196_en.htm

72 Prospectus Directive Article 5(2) and Prospectus Regulation Article 16(1).

73 Prospectus Directive Article 21(4)(a) and similar language in Prospectus Regulation Article 32(l).

74 Prospectus Regulation Recital 54.

75 Prospectus Regulation Article 16(1).

76 ibid Article 1(3) (replaces Prospectus Directive Article 3(e)).

77 ibid Article 16(1).

78 ibid Article 16(5).

79 Consumer behaviour is an important mechanism for changing corporate behaviour on ESG factors, and as such retail investors can help accelerate corporate consideration of ESG risk if they change their investment behaviour accordingly. However, retail investors are likely to rely mainly on the prospectus summary, which only lists the 15 key risks attached to an investment (Prospectus Regulation Article 7(10)). If ESG risks are not among these key risks, they will not likely be part of a retail investor's investment decision.

80 Regulation (EU) No 1286/2014 of the European Parliament and of the Council of 26 November 2014 on key information documents for packaged retail and insurance-based investment products (PRIIPs) [2014] OJ L 352/1. (PRIIPs Regulation).

81 Evershed Sutherland, "PRIIPs and PRIIPs KID Update" 17 May 2016 available at: http://www.eversheds-sutherland.com/global/en/what/articles/index.page?ArticleID=en/Financial_institutions/PRIIPs_PRIIPs_KID_Update

82 Funds covered by the rules for Undertakings for collective investment in transferable securities (UCITS) benefit from a five-year transitional period before the PRIIPs rules will apply.

83 PRIIPs Regulation Article 8(3)(c)(ii).

84 ibid Article 8(4).

85 ibid Article 8(4).

86 ibid Article 33(1).

87 ibid Article 8(3)(c)(ii).

88 ibid Article 16(8) and Article 17(7).

89 Whilst the Parliament had suggested that the full set of ESG factors should be covered by the (rather limited) provisions

above, member states wanted to restrict the rules to the disclosure of environmental factors and certainly avoid disclosure of (corporate) governance-related factors. Hence, a compromise between "E" and "ESG" was found in covering "ES" factors, but not "G" factors, which are explicitly excluded throughout the Regulation.

90 The legislation currently in place is known as the CRD IV package and includes Council Directive 2013/36/EU of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC [2013] OJ L 176/338 and Council Regulation (EU) No 575/2013 of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 [2013] OJ L 176/1.

91 FSB-TCFD, "Recommendations of the Task Force on Climate-related Financial Disclosures" (2016) available at: https://www.fsb-tcfd.org/publications/recommendations-report/

92 Proposal for a Regulation of the European Parliament and of the Council laying down common rules on securitisation and creating a European framework for simple, transparent and standardised securitisation and amending Directives 2009/65/EC, 2009/138/EC, 2011/61/EU and Regulations (EC) No 1060/2009 and (EU) No 648/2012, COM(2015) 472 Final, 30 September 2015 and Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms [2013] OJ L 176/1..

93 European Commission, "Securitisation" [nd] available at: https://ec.europa.eu/info/business-economy-euro/banking-and-finance/financial-markets/securities-markets/securitisation_en

94 Report on the proposal for a regulation of the European Parliament and of the Council laying down common rules on securitisation and creating a European framework for simple, transparent and standardised securitisation and amending Directives 2009/65/EC, 2009/138/EC, 2011/61/EU and Regulations (EC) No 1060/2009 and (EU) No 648/2012 (COM(2015)0472 – C8-0288/2015 – 2015/0226(COD)) Committee on Economic and Monetary Affairs, Rapporteur: Paul Tang, European Parliament Plenary Sitting, 19 December 2016, available at: http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//NONSGML+REPORT+A8-2016-0387+0+DOC+PDF+V0//EN (Proposal for a Regulation).

95 Proposal for a Regulation Article 10(3a).

96 Directive 2014/91/EU of the European Parliament and of the Council of 23 July 2014 amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards depositary functions, remuneration policies and sanctions [2014] OJ L 257/186.

97 UN OHCHR, "Fact Sheet No.2 (Rev.1), The International Bill of Human Rights," (1996), available at: http://www.ohchr.org/Documents/Publications/FactSheet2Rev.1en.pdf "The International Bill of Human Rights consists of the Universal Declaration of Human Rights, the International Covenant on Economic, Social and Cultural Rights, and the International Covenant on Civil and Political Rights and its two Optional Protocols."

98 ILO, "Conventions and Recommendations" (2017) available at: http://ilo.org/global/standards/introduction-to-international-labour-standards/conventions-and-recommendations/lang--en/index.htm

99 UN, "UN Guiding Principles on business and human rights: Implementing the United Nations "Protect, Respect and Remedy" Framework " (2011) HR/PUB/11/04, (2011) United Nations. (UN Guiding Principles). The Council of the EU has committed to contributing and encouraging the implementation of the UN Guiding Principles. Council of the EU, "EU Strategic Framework and Action Plan on Human Rights and Democracy", 11855/12 (25 June 2012) available at: https://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/EN/foraff/131181.pdf The EU has expressed its adherence to the Principles: EU, "Statement at the United Nations Human Rights Council Forum on Business and Human Rights" (Geneva 3-4 December 2013) available at: http://eeas.europa.eu/archives/delegations/un_geneva/documents/eu_statments/human_right/2013-1203_forum_buz_hr-panel-i.pdf and the European Commission has endorsed the UN Guiding Principles see: European Commission, "Corporate social responsibility in practice" [2017] available at: http://ec.europa.eu/growth/industry/corporate-social-responsibility/in-practice

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102 UN-supported Principles of Responsible Investment, "About the PRI" available at: https://www.unpri.org/about

103 United Nations Information Portal on Multilateral Environmental Agreements (InforMEA), "Treaties" (nd) provides a list of international environmental treaties see: https://www.informea.org/treaties

104 We consider that ESG risks should be understood in an integral fashion which is in line with international hard and soft human rights law: (i) Environmental risks – should be interpreted as including climate change risks as well as environmental destruction (ii) Social risks – should be understood in terms of incorporating issues related to human rights violations and abuses including: those that contribute to land-grabbing and deforestation (iii) Governance risks – should be understood not only in terms of incorporating risks accruing from the internal management failings of a company, but also those stemming from a failure to exercise due diligence to avoid environmental and social risks that could lead to financial costs and/or potential reputation costs, criminal or civil liabilities resulting from "stranded assets", human rights violations and abuses linked to any investments made. Implicit here is the fact that the financial industry must avoid investments in jurisdictions where there is little if any guarantee that they will not result in negative environmental and social impacts, including land grabs and deforestation, because of weak rule of law, corruption, a lack of political will to end impunity in cases of human rights violations and abuses, or the promotion by a host state of legislation and policies which weaken or undermine Free, Prior and Informed Consent rights or otherwise facilitate land-grabbing. Careful exercise of due diligence would mean that the manager or promoter of an investment instrument would seek to actively avoid permitting investments in these jurisdictions and drawing financial benefit from these contexts. ESG interpreted in this holistic fashion may help give substance to what is meant by sustainable development and sustainable finance.

105 UN Guiding Principles Principle 15 states that enterprises should inter alia implement: "A human rights due diligence

process to identify, prevent, mitigate and account for how they address their impacts on human rights".

106 ibid Principle 26.

107 "The EU's Business: Recommended actions for the EU and its member states to ensure access to judicial remedy for business-related human rights impacts", (Access to Justice Business and Human Rights) (December 2014) available at: http://www.accessjustice.eu/downloads/eu_business.pdf (The EU's Business).

108 Council Regulation (EC) No 864/2007 of 11 July 2007on the law applicable to non-contractual obligations (Rome II) [2007] OJ L199/40 Article 7.

109 The EU's Business.

With thanks to Joost Mulder, Financial Legislation Expert, for his advice and input in the production of this document.

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Friends of the Earth Europe gratefully acknowledges financial assistance from the European Union and DGIS. The sole responsibility for the content of this publication lies with Friends of the Earth Europe. It does not necessarily reflect the opinion of the funders mentioned above. The funders cannot be held responsible for any use that may be made of the information contained therein.