POLICY NOTE

Towards peace-positive investment

Bringing investors and fragile and conflict-affected states together, sustainably

About International Alert

International Alert works with people directly affected by conflict to build lasting peace. We focus on solving the root causes of conflict with people from across divides. From the grassroots to policy level, we bring people together to build sustainable peace.

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About the project

This policy note aims to guide investors and regulators towards sustainable investments that contribute to peace. Based on recent analysis by International Alert, it outlines practical steps that investors and regulators can and are taking to ensure that investments are conflict-sensitive, peace-positive and actioned within a stronger environmental, social and governance framework.

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Peace-positive investment: seeing missed opportunities

The global financing gap of approximately US$100 trillion indicates that through public investment alone, there is no chance of achieving the Sustainable Development Goals by 2030.[1] Private investment can therefore play a valuable role and affect the futures of fragile and conflict-affected states (FCAS). Sustainable finance is a vital part of the solution.

Sustainable finance possibilities have grown rapidly in recent years, driven by societal pressure and growing demand across the finance ecosystem to identify greater long-term financial returns and better alignment of investments with values, particularly relating to environmental, social and governance (ESG) issues.

The so-called 'ESG investments' – sustainable finance that aims to optimise environmental, social and governance outcomes – are currently a US$35 trillion industry.[2] By 2025, global assets managed in ESG portfolios are expected to reach US$53 trillion. Coupled with unprecedented global action on climate change, investments targeting the acceleration of climate adaptation and mitigation are surging.

Yet the majority of ESG investments are in advanced economies. Only 1% of global flows of foreign direct investment (FDI) is made in FCAS.[3] Despite pursuing private investment, FCAS remain heavily reliant on humanitarian and development finance.

Home to 23% of the world's population, fragile and extremely fragile countries are the source of many products critical to the global economy; nevertheless, these countries account for just 2.7% of global gross domestic product.[4]

Moreover, between 2012 and 2018, the gap between extremely fragile and non-fragile contexts widened significantly[5] and with that, a reduction in access to investment. Angola, Iraq, South Sudan and Yemen have experienced significant disinvestment. FDI to fragile contexts, already a small fraction of total global FDI flows, has further declined since 2015. Few FCAS have attracted significant volumes of FDI in recent years and that investment is predominantly within the extractive sector.

Fragile countries are most in need of investment which can unlock their potentials for growth, jobs, addressing the root causes of conflict and fragility. This calls for investments that are intentionally defined towards peace, with targeted social and environmental impacts that address conflict dynamics and contribute to a more peaceful environment.

Why are FCAS caught in this lack of investment trap? Investors see FCAS environments as too challenging for doing business, conscious that conflict-insensitive investments risk doing harm, exacerbating injustices and fuelling violence. In the absence of agreed global standards and common indicators on ESG, the impacts of investments on peace or conflict are often neglected.

The missed opportunities are considerable. Investors could be tapping into new markets that are resource-abundant and primed for growth, while the FCAS themselves urgently need financial investment to unleash economic development and build peace.

This policy note describes how investors and regulators can unlock the opportunities for responsible and sustainable investment in FCAS. It discusses three key areas for action: doing no harm through adopting a conflict-sensitive investment, building targeted investment that contributes to creating peace dividends, and a stronger ESG framework that integrates conflict-related risk and impact.

1. Conflict-sensitive investment

Why conflict-sensitive investment is important

When investors fail to understand conflict, cycles of violence can worsen and profits suffer. The harms caused by conflict-insensitive investment can be extreme.

In the Democratic Republic of Congo, investments in the Plantations et Huileries du Congo palm oil plantations are linked to human rights abuses against local communities.[6] In Myanmar, Dutch pension funds held US$2.3 billion of investments in 20 local companies with direct and longstanding ties to the military responsible for genocidal acts against the Rohingya.[7] In the Occupied Palestinian Territories, companies continue to exploit the natural resources in illegal settlements.[8]

Smallholder farmers use guide ropes to neatly and evenly sew okra seeds in a field outside Palabek Refugee Settlement in northern Uganda, east Africa. © Jake Lyell/Alamy Stock Photo

The risks of exacerbating conflict are not always obvious. For example, as policy makers and investors step up climate adaptation and mitigation financing to meet net zero ambitions, a limited but growing body of global case studies suggests these investments have the potential to intensify conflict, albeit in unintended and unexpected ways.

An example of this was seen when the United Nations Framework Convention on Climate Change's Clean Development Mechanism funded a hydroelectric dam in Santa Rita, Guatemala. The project failed to take account of conflict dynamics resulting from the Guatemalan civil war and threatened Mayan communities' access to water, food and sacred sites. After the disputes became violent and seven people died, the project was eventually cancelled.[9] Stronger conflict assessment and analysis could have helped to circumvent this seriously negative outcome.

Failure to understand conflict can lead to adverse consequences and present an existential risk to investments. Getting investment 'right' is made harder by due diligence processes which treat conflict in a silo, as just one of many human rights issues. In fact, the interplay between conflict and other issues, such as climate change, can present the greatest risk to investments.

To mitigate risk, investors can instead use conflict as a contextual lens through which to observe and analyse the broader range of risks to the company, such as the natural environment and climate change. Without employing this lens, the costs to investment portfolio profit, people and the planet can be considerable.

Ways to integrate conflict sensitivity into investments

International Investors are increasingly appreciating that risk can be mitigated by integrating conflict-sensitivity analysis into their investments. This supports the stability of fragile societies and reduces the risk of doing harm, while deepening the impact of the investment and protecting it from risk.

Development finance institutions (DFIs) are integrating conflict-sensitive approaches into their underwriting processes and in the design and implementation of investment projects:

- In 2019, the International Finance Corporation (IFC) developed the Fragility Lens, a conflict-sensitive approach to working in countries recovering from conflict.[10]
- The European Investment Bank (EIB), one of the first DFIs to incorporate a conflict-sensitive approach in investment analysis, is supported by a conflict-sensitivity helpdesk.

In high-risk or conflict-affected regions, some investors are performing due diligence and applying conflict-sensitive approaches in the ways that they engage with companies:

Self-assessment: Climate financing and the Global Environment Facility's Scientific and Technical Advisory Panel report

In 2020, the Global Environment Facility (GEF) carried out **a self-assessment** of how it had applied conflict sensitivity in its environmental and climate programmes. The assessment represented the culmination of a series of efforts made by GEF to better understand and manage conflict risks.

The GEF's **Scientific and Technical Advisory Panel (STAP)** published **Environmental Security: Dimensions and Prioritie**s in 2018, actioning a 2014 recommendation that the GEF should pay more attention to the issue of environmental security.

The STAP report noted that, "conflict, irrespective of its source, affects the viability or sustainability of investments in environmental protection… addressing environmental security in an explicit, consistent and integrated manner is essential to delivering global environmental benefits, including the long-term sustainability of project investments."

The STAP report recommended that the GEF:

- explicitly address environmental security in project and programme design;
- assess conflict risk routinely among investment risks beyond the scope of GEF intervention;
- evaluate the relationships between environmental change and vulnerability within GEF intervention, using tools such as the Resilience, Adaptation Pathways and Transformation Assessment (RAPTA) framework; and
- contribute to conflict prevention through environmental cooperation with others by building the capacity of civil society.

The GEF's STAP report is a good example of how institutions responsible for making significant investments can challenge themselves to do better and invest in ways that reduce risks to stability and their investments.

- In 2021, Dutch pension fund APG engaged with South Korean steel producer Posco C&C over human rights concerns related to the company's relationship with Myanmar Economic Holdings Limited owned by the Myanmar military junta. Posco C&C subsequently announced it would end its relationship with Myanmar Economic Holdings Limited.[11]

Some investors are collaborating with civil society actors to seek guidance on strengthening their conflict-sensitivity capacity:

- Achmea Investment Management worked closely with civil society organisation PAX to develop public investor guidance on navigating conflict-related human rights risks.[12]
- Some institutional investors are working with Heartland Initiative, a non-profit US practice-based research organisation, through the Sustainability Accounting Standards Board (SASB)-Rights CoLab, to implement rights-respecting investment practices in conflict-affected and high-risk areas.[13]

Despite these examples of progress, much more needs to be done. The IFC urges better understandings of the ways the private sector can contribute to conflict prevention and is calling for "a common set of principles on conflict-sensitive approaches to investment, to provide DFIs and other investors a framework for operating in challenging environments." To achieve this, IFC suggests building mechanisms across DFIs for the purpose of sharing knowledge and developing joint solutions to operating sustainably in fragile and conflict-affected states.[14]

Recommendations

To maximise potential, for the benefit of people in fragile and conflict-affected states and investors, and to ensure that investments are made responsibly and conflict risks are mitigated and managed, ESG investments must establish a minimum level of conflict sensitivity and avoid doing harm. The following are specific recommendations for action:

- DFIs, which are particularly well-placed for accelerating conflict-sensitive frameworks among private investors and developing shared principles and approaches, should build on the successful examples of the IFC, EIB and others.

- Investors should integrate conflict analysis into their environmental and social due diligence, following the UN Guiding Principles and OECD guidelines on heightened due diligence. The mounting climate crisis and increasing investment in climate adaptation and mitigation amplify the importance of integrated conflict-sensitive approaches to investment. Investors in FCAS and other high-risk settings and sectors have a heightened responsibility to do due diligence effectively across conflict, climate and human rights.
- Financial regulators should explicitly include conflict assessments as part of the mandatory due diligence requirements carried out on environment and human rights. Regulators should require conflict analysis to be conducted by investors operating in FCAS. Where possible, the conflict risk assessment lens should be used to investigate and understand other intersecting risks, such as climate change.

2. Peace-positive investment

Why peace-positive investment is important

Long-term investors, such as pension funds, are increasingly aware of vulnerabilities to ESG risks. Asset managers are conscious that risks such as climate change can adversely affect the value of their assets and therefore they follow a strategy of divestment,[15] reacting to risk by divesting itself of the riskiest assets.

Current practice is based on the need to consider a corporate harm to people and the environment only if that practice rebounds negatively on the business in the form of reduced returns.[16] Such an approach, largely reactive and opportunistic in nature, can significantly limit the opportunities for financial return, while also wasting potential opportunities to address long-term risks positively.

A core principle of ESG investments is to make positive long-term impacts and go beyond the minimum requirement of safeguarding and doing no harm. This may be best achieved by setting clear objectives for how an investment will contribute to social and environmental development and transformation. For areas affected by conflict, these investments could direct their impact to addressing conflict dynamics such as socio-economic inequalities, exploitation of weak governance or historic grievances and as a result contribute to a more peaceful society. The principle of "double materiality" – that companies should factor in and report on how their actions impact materially on risks such as climate change, as well as on their profits – emphasises how companies and investors can benefit by being intentional about their long-term objectives.

The European Commission explains in the Non-Binding Guidelines on Non-Financial Report Update,[17] "The positive and/or negative impacts of a company on the climate will increasingly translate into business opportunities and/or risks that are financially material."

There is a growing expectation from shareholders and society that investors committed to the core principles of ESG will invest accordingly, not only to avoid doing harm, but to achieve a positive impact, which includes helping to build peace and stability.

By targeting much-needed conflict-sensitive investment to fragile settings, as part of a longer-term strategy, investors can make positive material impact on their profits and for the societies within which they are operating. People in fragile and conflict-affected states have great need for peace-positive investments which have clear objectives to build social and environmental capital and contribute to stability and development.

Encouragingly, developments in both policy and practice are now showing investors compelling and attractive ways to make their investments peace-positive.

How to make investments peace-positive

Global investors are finding ways to increase and strengthen their portfolios so that they can contribute to social and environmental objectives, improve development outcomes, build peace and stability, and reduce fragility.

Institutional investors, pension funds and insurance companies are particularly well-placed to invest long-term. Their large, diversified portfolios enable greater access to long-term opportunities. For this to happen, they require long-term risk assessment, to make portfolio choices. Investors that do not require short-term liquidity are also in a better position to influence the management of the companies in which they invest.

- In 2020, APG pension decided to invest only in companies that pay attention to human rights, the

Kabeli B-1 Hydroelectric project (intake section) on the Kabeli river between Thumbeding and Tharpu, Taplejung & Panchar District, Nepal. © Marc Boettcher/Alamy Stock Photo

environment and corporate governance and those it could expect to be able to influence towards making improvements in these areas.

- Investors such as Robeco Asset Management, the California Public Employees' Retirement System and SEB Investment Management are taking practical steps to facilitate greater environmental and social impact through their investments.

Specialised financing instruments play a niche but important role in creating space conducive to increased peace-positive investment. Blended concessional finance,[18] pooling concessional funds from development partners with commercial finance, is particularly promising as an instrument for encouraging private investment in FCAS in a way that addresses critical social and environmental issues.

The development of specialised financing instruments can be achieved through innovative partnerships engaging the private sector, DFIs, philanthropic actors and the humanitarian community.[19]

GEF and IFC are developing specialised financing instruments and are able and willing to fund projects in conflict-affected situations. Seed funding and pilot projects lay the groundwork and catalyse to generate additional investment by others.[20]

Recommendations

ESG investments can achieve much more than just avoid doing harm. Unlocking the peacebuilding potential of ESG investments to meet the significant needs in FCAS requires more peace-positive investment, supported by greater piloting, testing and scoping of what works. The specific recommendations for action on peace-positive investments are as follows:

- ESG investors should broaden their portfolios and explicitly pursue positive impacts that address conflict and fragility risks and contribute to creating a better environment for peace in its social and environmental drivers.
- Rather than divesting or withdrawing from higher-risk conflict settings, ESG investors should maintain investment portfolios that can make a positive long-term contribution to peace, while ensuring a conflict sensitive approach.
- ESG investors and DFIs are encouraged to explore, develop and scale up new partnerships and specialised financing instruments, such as blended concessional finance, to attract and incentivise private investment supportive of development and peace in FCAS.

- Investors should prioritise FCAS for FDI in sectors beyond extractive industries, especially those that add and retain significant value in country.

Investors, international institutions and peace actors should upscale research to support the development of effective mechanisms for making peace-positive investments. These include assessments and monitoring and evaluation of what works best for building long-term peace.

3. A stronger ESG framework

Why a stronger ESG framework is needed

ESG investors taking steps to expand their ESG portfolios, and seeking to ensure their investments are conflict-sensitive and peace-positive, are much needed. Yet without an agreed global ESG framework that accounts for conflict risks and supports peace-positive investment, such actions remain piecemeal.

The present ESG framework is inadequate as it does not provide a clear definition of sustainable, green or social investment. Other emerging standards, such the European Union (EU) Sustainable Finance Disclosure Regulation (SFDR), continue to emphasise the environmental "E" of ESG, while lacking a universally agreed standard for measuring the progress made by a company on the social front.

A 2019 OECD report noted, "Social impact investment, which aims to improve wellbeing as well as earn a financial return, could be more effective if it were more clearly defined internationally with more measurable outcomes."[21]

Current ESG indicators and metrics are vague and various. As well, today's market practices, from ratings to disclosures and individual metrics, present a fragmented and inconsistent view of ESG risks and performance. This leaves investors ill-equipped, basically unable to assess performance against general ESG goals or more targeted social and environmental objectives, such as peace-related objectives. Unsurprisingly, adherence to standards remains largely voluntary and based on individual investor goodwill.

The lack of a clear framework and regulations increases the risk of investors and companies doing harm or fuelling conflict and leaves the most willing peace-positive ESG investors unsupported, vulnerable to damaging their bottom line. The absence of objective, standardised and clearly defined definitions and indicators also allows significant and widespread risks of 'green-washing' and 'social-washing' by businesses eager to promote false perceptions of their environmental and social performance. Essentially, a strong ESG framework is needed to enable investors to differentiate good from bad practice and invest accordingly.

How a stronger ESG framework is emerging

Regulators are responding to the need by developing new ESG standards.

At the 2021 COP26 climate conference, the International Financial Reporting Standards Foundation announced the formation of an International Sustainability Standards Board (ISSB) which is tasked to develop a comprehensive global baseline of sustainability disclosure standards, to meet investor information needs.

The European Commission Platform on Sustainable Finance is working on the Environmental[22] and Social[23] Taxonomies to define and classify 'sustainable' economic activities and environmental and social investments.

The EU is considering legislation to establish human rights and environmental due diligence obligations for corporations. To that end, the European Commission recently published a new directive on mandatory human rights and environmental supply chain due diligence.[24] This directive requires that companies undertake ongoing global due diligence on potential or actual adverse impacts on human rights, the environment and good governance across their value chain. It requires EU member states to ensure that companies are held liable and required to remediate any harm.[25] The success of these initiatives may ultimately determine whether the sustainable finance sector can bridge the reporting gap and standardise definitions for reporting on their impact on sustainability and peace.

Recommendations

Improving ESG frameworks, by developing stronger and clearer definitions and regulations will benefit both the people of FCAS and investors. The new frameworks from the ISSB and the EU are reaching beyond the 'do no harm' approach to incentivise investors towards making positive impacts. To this end, the frameworks must be explicit about the peace and conflict impacts of ESG investments, standardise definitions and metrics around how ESG investments can build dividends for peace and stability, reduce fragility and contribute to both the UN Sustainable Development Goals and the national development objectives of FCAS. The following are the specific recommendations for action:

- Based on the Sustainable Development Goal 16, the ISSB and the EU Platform on Sustainable Finance should integrate peace-related outcomes into the new sustainability standards under development.
- The EU's new directive and mandatory due diligence standards should go beyond the 'do no harm' approach and address the investor's role in ensuring the positive impact of their operations in FCAS.
- Investors, international institutions and peace actors should share their learning on peace indicators and best practices, to inform the development of new international standards around ESG.
- Financial regulators should look more explicitly at the interplay between conflict and environmental issues. More attention should be given to social and conflict risks when considering responses to climate change.

Conclusion

Sustainable finance must not exacerbate conflict but instead contribute positively to peace. Done well, sustainable finance involving conflict-sensitive, peace-positive investment, can benefit both the investors and the people of fragile and conflict-affected states.

Supported by clear, established and enforecable standards, peace-positive investment could unlock billions of crucially-needed funding for FCAS and help pave the way to long-term development and peace.

Global investors and regulators are stepping up, coming together with peace actors in joint initiatives, developing much-needed tools to help stakeholders define, measure and understand what works well, and exploring opportunities and appropriate pathways for taking peace-positive investment to scale.

Endnotes

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