



To:

Dr. John Ruggie
United Nations Secretary General's Special
Representative on Human Rights & Business
Harvard University, Center for Business and Government
John F. Kennedy School of Government
Weil Hall, 79 John F. Kennedy Street
Cambridge, MA 02138
United States

Subject:

The role of the financial services sector in respecting human rights

Date

Utrecht, December 18th 2006

Dear Dr. Ruggie,

As you prepare your Final Report to the UN Human Rights Council, BankTrack would like to present the following submission regarding the role and responsibility of banks in respecting human rights. We have understood that you are preparing a one day consultation on precisely this topic next February and we would be pleased to contribute to this event.

As you may know, BankTrack is a network of 16 civil society organizations in 11 countries, a unique confederation of advocacy groups dedicated to advancing environmental and social sustainability in the commercial/investment banking sector. Although many BankTrack member organizations have been campaigning for bank environmental and social financing standards for several years, the network was formalized in January 2003 with the launch of the Collevocchio Declaration. This statement, which was endorsed by over 100 organizations, expresses civil society's expectations regarding the role and responsibility of financial institutions in advancing sustainability.¹ In particular, human rights was explicitly identified as an important issue for financial institutions to address.

Earlier this year, BankTrack published a survey of best practice standards in the banking sector; '*Shaping the Future of Sustainable Finance*'. It found that relatively few major

¹ See <http://www.banktrack.org/?show=33&visitor=1>

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banks have established human rights policies, and those which had were not clear about how those policies translated into financing activities.² In addition, BankTrack members recently have published numerous analyses focused entirely on banks and human rights, including: *Where do you draw the line? Research on financial links between five bank groups and companies involved in serious violations of human rights* (Netwerk Vlaanderen, November 2005), *Explosive portfolios: banks and cluster munitions* (Netwerk Vlaanderen, July 2006) and *Solidly Swiss? Credit Suisse, UBS and the global oil, mining and gas industry* (Berne Declaration, July 2006).³ **These reports have found that banks are routinely complicit in violating human rights, yet they operate with impunity—without accountability in the home country where they are based, nor in the country where their transactions / the violations occur.**

Finally, BankTrack members have consistently advocated for higher standards and accountability during the drafting and revision of the Equator Principles, a set of voluntary standards that are endorsed by only a small fraction of banks and which represents less than five percent of bank financing activities by volume. **The Equator Principles apply to only a tiny fraction of bank financing activities, and do not adequately address human rights.**

In the remainder of this letter we would like to present you with a few illustrative examples of bank complicity with human rights violations, and present our thoughts on why the emergence of the Equator Principles are not the solution to this ongoing situation. We would be happy to elaborate further on this during the meeting in February.

A. Some examples of bank complicity and impunity in violating human rights

Freeport McMoRan: Equity and debt underwriting, syndicated lending

There are long-standing indigenous peoples and human rights violations surrounding Freeport McMoRan's Grasberg mine in Indonesia, particularly with respect to the company's ties with Indonesian military. After years of pressure from shareholders and NGOs, the company finally admits that has and continues to support "government-provided security," which currently involves over 2,400 troops and police. From 2001-2005, the company has paid some \$18.76 million,⁴ although it has certainly made similar payments for security during its 30+ years in Indonesia (these dollar figures are not public, however).

Human rights violations committed by the Indonesian military became particularly grave as the company began implementing a US\$1 billion expansion plan to almost double throughput to over 200 million tons per day. Perhaps the best-known case involves Goldman Environmental Prize winner Yosepha Alomang, an outspoken indigenous

² *Shaping the Future of Sustainable Finance*, WWF and BankTrack, January 2006 (human rights section) www.banktrack.org/doc/File/BankTrack%20publications/Best%20practices/part%201%20human%20rights.pdf

³ See <http://www.banktrack.org/?show=86&visitor=1>

⁴ From Freeport McMoRan SEC Form 10-K filings, 2002-2006.

(Amungme) woman who was critical of the mine. In 1994, she was captured by soldiers, held in a container filled with water and feces, and tortured and interrogated for six weeks.

Freeport's aggressive mine expansion was only made possible by a massive capital raising campaign, in which banks underwrote new equity shares and bonds, and lent hundreds of millions of dollars in general purpose loans. For example:

In 1993, Lehman Brothers, Kidder, Peabody & Co., Goldman, Sachs & Co. and Merrill Lynch underwrote gold-denominated preferred shares, which raised \$233 million for the company. Months later, in 1994, Lehman Brothers, Kidder, Peabody & Co, Merrill Lynch, and SG Warburg (now UBS) underwrote an additional 3.75 million new shares of gold-denominated stock for Freeport McMoRan,⁵ which netted the company another \$138.5 million. Lehman Brothers, Goldman, Sachs, Merrill Lynch, S.G. Warburg (UBS) underwrote silver-denominated shares for the company as well, raising \$100 million for the company.⁶

The company has also borrowed money through issuing bonds. For example, in 1996, Lehman Brothers, Merrill Lynch and Salomon Brothers (Citigroup) underwrote \$150 million in senior notes for the company.⁷ Later, UBS Securities, Chase Securities and CS First Boston underwrote \$200 million in senior bonds, and another \$250 million in debentures (long-term bonds).⁸ The company raised an additional \$120 million by having an associated company, P.T. ALatieF Freeport Finance Company, issue senior notes underwritten by Chase and CS First Boston.⁹

The company naturally relied on bank borrowing as well. In the mid-1990s, a syndicate of banks including Barclays, NatWest, ABN AMRO, BNP, Deutsche Bank, Landesbank Berlin, and De Nationale Investeringsbank, gave the company a \$225 million syndicated loan.¹⁰

Although affected communities attempted to hold Freeport accountable for human rights violations through lawsuits, there were no similar avenues available to hold bank financiers accountable, despite their clear role in facilitating the company's rights-violative activities.

Flextronics: Equity and debt underwriting, syndicated credit facilities

Labour rights abuses among global electronics contract manufacturers is a well-documented phenomenon. One notable analysis includes the 2004 report *Clean up your computer; Working conditions in the electronics industry*, published by CAFOD, a British NGO. The investigation was based on fieldwork in Mexico, Thailand and China, and it documented labour rights violations at contract manufacturers supplying big brands like IBM, HP and Dell. The report found violations such as excessive overtime, worker intimidation for attempting to organize, and mandatory pregnancy testing for prospective employees.

⁵ Freeport McMoRan, Prospectus Supplement dated January 13, 1994, to Prospectus dated July 21, 1994.

⁶ "New Issues (July 18, 1994 - July 27, 1994); Equity," *Investment Dealers' Digest*, July 27, 1994.

⁷ New Issues (February 12, 1996 - February 26, 1996); Debt," *Investment Dealers' Digest*, February 26, 2006.

⁸ "New Issues (November 11, 1996 - November 21, 1996); Debt," *Investment Dealers' Digest*, November 25, 2006.

⁹ Freeport McMoRan, SEC Form S-3, filed February 14, 1994.

¹⁰ Freeport McMoRan, 1994 SEC Form 10-K.

Some of the largest contract manufacturers are publicly-listed companies, such as Silicon Valley-headquartered Flextronics, which states that “the majority of our manufacturing capacity is located in low-cost regions such as Mexico, Brazil, Poland, Hungary, China, India, Malaysia and other parts of Asia.”¹¹ Many of these countries have known labour rights problems, and in 2006 Centro de Reflexión y Acción Laboral (CEREAL) published a report that specifically documented worker health problems at a Flextronics plant in Guadalajara, Mexico.¹²

Since its \$35 million initial public offering in 1994, made possible by Montgomery Securities and Cowen & Co,¹³ Flextronics has grown rapidly with the backing of many investment and commercial banks. Investment banks have helped the company issue bonds, such as a \$150 million tranche of bonds which BancAmerica Robertson Stephens, BancBoston Securities, Donaldson Lufkin and Bear Stearns underwrote in 1997,¹⁴ and a \$500 million convertible bond underwritten by Lehman Brothers, CSFB and Citigroup in 2003.

The company has also issued new stocks on several occasions, such as a \$89.3 million issue of new common stock underwritten by Montgomery Securities, Cowen & Co., Salomon Brothers (Citigroup) and UBS Securities in 1997,¹⁵ and a \$260 million stock issue in 1998 underwritten by Nations Banc.¹⁶ Other banks are often the biggest buyers of Rolltronics stock – for example, as of June 2005, Belgium-based bank and insurance company AXA held an astounding 30.49% of Flextronics shares.¹⁷

Finally, the company has also borrowed directly from banks, such as a 1997 BankBoston-led credit facility worth \$175 million.¹⁸ Today, Flextronics taps a \$1.35 billion revolving credit facility led by ABN AMRO. Other banks in the syndicate include the Bank of Nova Scotia, Bank of America, Citicorp USA, Deutsche Bank, BNP Paribas, Credit Suisse, Merrill Lynch Capital Corporation, Skandinaviska Enskilda Banken, HSBC Bank USA, Barclays Bank PLC, KeyBank National Association, Royal Bank of Canada, UBS Securities.¹⁹ This financing allowed the company to expand from operating in fewer than 10 countries in 1994 to over 30 in 2006. While the firm’s labour and human rights risks increased along with its geographical expansion, there is little evidence to suggest that banks played positive role in ensuring that these risks were minimized.

National Hydroelectric Power Corporation: Syndicated bank lending

India’s state-owned National Hydroelectric Power Corporation (NHPC) specializes in developing large, and often politically risky, dam projects. The company has a notorious record of providing inadequate compensation to displaced people, and of resorting to

¹¹ Flextronics website, <http://www.flextronics.com/en/AboutUs/Backgrounder/tabid/62/Default.aspx#06>

¹² Centro de Reflexion y Accion Laboral, “New Technology Workers: Report on Working Conditions in the Mexican Electronics Industry,” June 2006.

¹³ “New Issues; Equity,” *Investment Dealer’s Digest*, March 28, 1994.

¹⁴ “New Issues: October 9, 1997 - October 16, 1997; Debt,” *Investment Dealer’s Digest*, October 20, 1997.

¹⁵ “New Issues; September 25, 1997 - October 2, 1997; Equity,” *Investment Dealer’s Digest*, October 6, 1997.

¹⁶ “Nations leaves syndicate fuming in block deal,” *Investment Dealer’s Digest*, December 14, 1998.

¹⁷ *Where do you draw the line? Research on financial links between five bank groups and companies involved in serious violations of human rights*, Netwerk Vlaanderen, November 2005.

¹⁸ Flextronics SEC Form S-1, May 21, 1998.

¹⁹ Flextronics SEC Form 8-K, June 3, 2005.

repressive means of countering community resistance. Villagers who will be displaced by NHPC's Indira Sagar dam in Madhya Pradesh have successfully delayed the project several times, but their non-violent protests have been met with force, intimidation and threats by India's Special Armed Forces. Similarly, eight peaceful protesters were killed by police in 2001 during a rally which urged NHPC to cancel the Koel Karo dam.

To finance its expansion, the NHPC has issued three tranches of bonds, and borrows from a wide range of Indian and international banks.²⁰ An international syndicate of banks led by Deutsche Bank, including Skandinaviska Enskilda Banken, Credit Commercialde France, HSBC, ABN Amro, ANZ, Barclays, Emirates, Natwest, Standard Chartered, and Sumitomo, provided NHPC with corporate loans that represented about 10 percent of the company's assets.²¹ In addition, Barclays and Standard Chartered led a \$50 million syndicated bank loan to the company in 2003.²²

Affected communities have been able to turn to the courts for some human rights violations associated with the company. For example, in 2003, affected people filed a case in India's Supreme Court against NHPC's Lower Subansiri hydropower project. In 2004, the Madhya Pradesh High Court accepted rehabilitation-related complaints by inhabitants of Harsud, a town submerged by the company's Indira Sagar dam. In the mid-nineties, the Guwahati High Court sentenced NHPC to pay compensation for farmers whose fields and fish farms were destroyed.²³ However, no similar means of recourse are available for commercial and investment banks, again illustrating that banks operate with impunity when they facilitate and benefit from rights violative activities.

B. The Equator Principles inadequately address bank responsibility in human rights

The Equator Principles, despite their recent claim to fame as the effective response of the financial sector to social and environmental risks, are not the answer to the problem of banks' complicity in human rights violations. To begin with, they apply only to a very limited segment of commercial and investment banking activities. The Principles themselves, which are based on the new International Finance Corporation (IFC) Performance Standards (PS), do not adequately address human rights. In addition, the Principles lack implementation and accountability systems.

Limited applicability of Equator Principles

Although the Equator Principles are well-known, they provide very little coverage of overall bank financing activities. As demonstrated by all of the abovementioned examples, banks can and do facilitate rights-violative activities through providing products and services

²⁰ NHPC annual report, 2004-2005.

²¹ International Rivers Network, Delhi Forum, Banktrack, Urgewald, South Asian Network for Dams, Rivers and People (SANDRP), *Financing Dams in India: Risks and Challenges*, February 2005.

²² "NHPC Signs Financing Pact For Ecb Of \$ 50 Million," *Financial Express*, December 11, 2003.

²³ International Rivers Network, Delhi Forum, Banktrack, Urgewald, South Asian Network for Dams, Rivers and People (SANDRP), *Financing Dams in India: Risks and Challenges*, February 2005.

other than project finance. Project finance is not a common method of financing timber, soya, palm oil and other plantations — activities that often involve significant land conversion and can negatively affect livelihoods and rights of communities traditionally located in the area. Project finance is also rarely used to finance controversial weapons production, mercenaries,²⁴ footwear and apparel manufacturing, and natural resource exploration.

In fact, project finance probably represents well under five percent of capital raised through commercial lending and investment banking services. Within an individual bank, project finance can represent as little as one or two percent of overall business; and in reality, some Equator signatories may not be involved in project finance at all. Finally, although a few banks have elected to apply the Equator Principles beyond their project finance operations (to corporate lending where use of proceeds is known and/or specified), the vast majority of corporate credits are for general corporate purposes, making this expansion relatively small.

Equator Principles themselves do not adequately address human rights

The second reason why BankTrack believes that the Equator Principles do not sufficiently cover banks' responsibilities with respect to human rights is due to the inherent weakness of IFC's (International Finance Corporation's) standards, upon which the EPs are based.

The Equator Principles and the underlying IFC PS fall short of international human rights law, particularly when compared with the broad spectrum of rights summarized in the Draft UN Norms. For example, the Equator Principles embrace the notion of "free, prior and informed consultation," a term that has no certain meaning, and which defies international laws (such as ILO Convention 169, UN Declaration on the Rights of Indigenous Peoples, Convention on Biodiversity) that guarantee the right to free, prior and informed consent for indigenous peoples.

Another example of where the Equator Principles fail to embrace emerging human rights norms (particularly those for enterprises) is its approach to security forces. The IFC PS incorporate some, but not all, of the US-UK Voluntary Principles on Security and Human Rights. Unlike the Voluntary Principles, the EPs do not explicitly require that the client holds consultations with affected communities on security matters (although this matter could be included in general community consultation procedures). Second, the EPs require a narrower and ill-defined version of security-related risk assessments. Whereas the Voluntary Principles require companies to assess the risks of potential violence beyond the immediate project site, as well as the root causes of the potential for future conflict, the EPs only require an assessment to ensure that "those providing security are not implicated in past abuses."

²⁴ According to the *Financial Times* (Ridding, John. "HK banker fired over mercenaries: Jardine Fleming acts on PNG," *Financial Times*, May 15, 1997), in 1997 a Jardine Fleming banker was sacked for providing financial advisory services to the Papua New Guinea government. The government wanted to source and finance mercenaries in an attempt to suppress a separatist uprising and protests against the huge Bougainville copper mine, operated by Rio Tinto. The mercenary scandal sparked such outrage that Julius Chan, the country's prime minister at the time, was forced to resign.

Moreover, the Equator Principles completely fail to address some significant human rights issues particularly relevant to project finance. One notable example includes revenue and contract transparency requirements advocated by the Extractive Industries Transparency Initiative and the Publish What You Pay Coalition. Although the IFC has introduced new revenue and contract transparency requirements for extractive industry projects, the Equator Principles do not require these standards, which are designed to minimize corruption in resource extraction projects.

The Equator Principles also do not prohibit the use of controversial economic stabilisation clauses in Host Government Agreements (HGAs), legal contracts that are often important parts of project finance transactions. Because of the non-recourse nature of project finance (wherein lenders only are repaid from the successfully-generated revenue of the project), creditors seek as much stability as possible over the maturity of their loans. HGAs create legal frameworks between investors and host governments, and usually include economic stabilisation clauses and other provisions which are designed to reduce financial risks due to unexpected and significant changes in law. However, HGAs may also have the effect of freezing labour, environmental and human rights protections during the entire duration of the project -- which can last anywhere from 20 or 70 years. This may result in a situation where "the threat of litigation on the basis of broadly interpreted expropriation provisions has a 'chilling effect' on government regulatory capacity, conditioning State action to promote human rights and a healthy environment by the commercial concerns of foreign investors."²⁵ For example, according to Amnesty International, the HGAs governing the Chad-Cameroon oil pipeline "may require the two countries to pay large financial penalties if they interrupt the operation of the pipeline or oil-fields – even when making an intervention to protect rights and enforce laws that apply elsewhere in their countries."²⁶

Equator Principles in practice: no accountability mechanisms

Finally, in practice, BankTrack believes that the Equator Principles are not a robust method for ensuring that banks avoid complicity in activities that result in or benefit from human rights violations. Based on the limited experience to date, Equator banks have been willing to finance projects that are non-compliant with the Principles. One notable example is the Sakhalin II project, in which nearly all the banks bidding to be the lead arranger are Equator banks.²⁷ Numerous NGO analyses have illustrated how this project, which is 80% complete, violates the Equator Principles. Experts warn that completing the project will threaten the critically endangered Western Gray Whale with extinction, and damage habitats of endangered bird and fish species. The project has already affected important fisheries resources – and some damage may be irreversible. In particular, the Indigenous Congress of Sakhalin states that, "harm done to the animal and plant world in traditional land-use areas takes a direct toll on the vital activities of indigenous peoples. Living a life

²⁵ Office of the High Commissioner of Human Rights, *Human Rights and Trade*, 5th WTO Ministerial Conference, Cancun Mexico, 10-14 September 2003. <http://www.unhchr.ch/html/hchr/cancunfinal.doc>

²⁶ "Chad-Cameroon pipeline: New report accuses oil companies and governments of secretly contracting out of human rights," Amnesty International press release, September 7, 2005. <http://web.amnesty.org/library/Index/ENGPOL300282005>

²⁷ See for example, BankTrack letter to Equator banks bidding to arrange Sakhalin II financing, <http://www.banktrack.org/?show=news&id=86>

style such as the indigenous do, is not taken into account, and isn't apparent to the management of 'Sakhalin Energy'."²⁸

Second, the Principles lack accountability mechanisms to ensure compliance, and they certainly are not designed to hold banks broadly accountable for facilitating activities that result in or benefit from human rights violations. For example, a BankTrack member group, acting on behalf of BankTrack and other NGOs, recently submitted an Equator Principles "compliance complaint" to Calyon (an Equator endorser), for its intention to finance the Botnia paper mill in Uruguay.²⁹ (It should be noted that Calyon stepped in to finance this project after another EP bank, ING, stepped out.) This complaint points out how the project violates both human rights and the Equator Principles. But it was submitted rhetorically, as the Principles do not have an initiative-wide vehicle for dealing with compliance problems. In the meantime, NGOs have pursued legal and other access to justice actions at the Inter-American Commission on Human Rights, the International Court of Justice, and the OECD Guidelines for Multinational Enterprises National Contact Point in Spain for human rights violations associated with this project.

From the EP's inception, BankTrack has consistently urged the Equator banks to adopt a set of minimum implementation and accountability requirements as part of the Equator commitment.³⁰ However, the Equator banks have consistently refused to do so. Its revised version does include a minimal reporting obligation on the implementation of the principles, but it deliberately lacks minimum requirements or standards.

Finally, it should be noted that the few existing banks' own stand-alone human rights policies face the same problems mentioned above; they similarly lack key requirements and prohibitions, and also do not have accountability mechanisms.

C. Conclusion

When considering the role of private business entities in relation to human rights, it is essential to consider not only the direct perpetrators of human rights violations, but also those who encourage, facilitate and benefit from violations. In many instances, operations that violate human rights could not proceed without the support of financial institutions. If the financiers can be made to exercise their considerable influence to prevent human rights violations rather than enabling them, great progress will be made in the realisation of human rights and the alleviation of human suffering.

We hope this submission a) adequately articulates the role and responsibility of the banking sector in human rights, b) illustrates the kinds of right-violative transactions that are financed through non-project finance means, and c) demonstrates how the Equator

²⁸ From Indigenous Congress letter to EBRD at <http://www.pacificenvironment.org/article.php?id=252>

²⁹ See http://www.cedha.org.ar/en/initiatives/paper_pulp_mills/compliance-complaint-calyon.pdf

³⁰ See for example, a proposed independent accountability mechanism, described in *No U-Turn Allowed: Recommendations to the Equator Banks*, January 2004.

<http://www.banktrack.org/doc/File/BankTrack%20publications/BankTrack%20publications/040120%20No%20U%20turn%20Allowed.pdf>

Principles are not sufficient to address banks' complicity in facilitating transactions that result in human rights violations.

We strongly encourage you to discuss the role of banks in your Final Report, and to call for a more comprehensive approach to human rights responsibilities in the banking sector. We hope that this submission has been helpful, and we look forward to discussing this matter in Geneva in February.

Sincerely,



Johan Frijns, coordinator,
on behalf of the BankTrack network

Amigos da Terra - Amazonia Brasileira
Berne Declaration
Campagna per la Riforma della Banca Mondiale -CRBM
Center for Human Rights and Environment - CEDHA
Fair Finance Watch
Friends of the Earth - FoE US
Friends of the Earth Netherlands - Milieudefensie
International Rivers Network - IRN
Les Amis de la Terre - FoE France
Mineral Policy Institute - MPI
Netwerk Vlaanderen
Platform
Rainforest Action Network - RAN
Urgewald
WEED
WWF-UK

Brazil
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Netherlands
United States
France
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United States
Germany
Germany
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