Banking it Right

The “protect, respect and remedy“ framework applied to bank operations

Submission to the “OHCHR consultation on operationalizing the framework for business and human rights presented by the Special Representative of the Secretary-General on the issue of human rights and transnational corporations and other business enterprises”

Geneva, 5-6 October 2009.

BANKTrack

BankTrack, a network of 30 civil society organisations tracking private finance, submits this discussion note to the OHCHR consultation on operationalising the „protect, respect and remedy" framework as presented by the Special Representative of the Secretary-General on the issue of human rights and transnational corporations and other business enterprises, John Ruggie, to the Human Rights Council.[1] *BankTrack has already commented earlier on various aspects of the Special Representative's work.*[2]

This is the first BankTrack submission since the outbreak of the financial crisis and it reflects the altered landscape regarding private finance.[3] *Nevertheless, the irresponsibility of some financial actors in causing this crisis and the ways in which the crisis affects the fulfilment of human rights are beyond the scope of this paper.*

Summary

BankTrack sees the current regulatory drive in the banking sector as an opportunity to advance the human rights agenda for banks. Governments and their agencies that are the main drivers of regulatory efforts should not miss this opportunity.

BankTrack's research and mapping exercise has shown, that human rights due diligence is still at a very early stage in most of the banks. To fulfil their duty to respect banks should develop human rights policies and due diligence procedures, that define which human rights-related activities and practices will not be financed or engaged in. The Special Representative's 2008-11 workplan should include efforts to map and clarify the full range of activities in which banks can, directly or indirectly, impact on human rights.

Banks should establish mechanisms that provide remedy for negative impacts of bank decisions. The signatories of the Equator Principles should agree to take a coordinated approach to accountability, including direct access for voices from affected communities, in order to ensure that the activities banks finance are not causing significant adverse impacts.

BankTrack hopes that this paper helps to advance the discussion on the relevance of the „protect, respect and remedy" framework for the banking sector. We are committed to advance this important agenda through our research, advocacy and campaign activities.

[1] A/HRC/8/5

[2] See www.banktrack.org/show/focus/banks_and_human_rights

[3] For BankTracks analysis of the crisis see: Bank to the future, El Escorial Statement of Banks and the Financial Crisis, November 2008, www.banktrack.org/download/bank_to_the_future_el_escorial_statement/escorial_declaration_final.pdf

I. Introduction

The aim of this discussion note is to highlight how the Special Representative's „protect, respect and remedy" framework applies to the banking sector. BankTrack welcomes the Special Representative's comments on the economic crisis and supports his aim to identify opportunities to advance the business and human rights agenda in times of crisis.[4]

II. State duty to respect

In his 2008 report to the Human Rights Council, the Special Representative states that "inducing a rights-respecting corporate culture should be easier to achieve in State-owned enterprises"[5]. Although governments avoided outright nationalization in their efforts to contain the financial crisis, they stabilized individual banks with massive capital infusions. This has given a number of states a direct influence in the financial industry not seen for decades. Even if controlling majority ownership of banks is the exception, those states have now much greater possibilities to influence bank behaviour. BankTrack advocates that governments should use this leverage to advance the human rights agenda in the banking sector.

In addition to their influence on individual financial institutions, government efforts to establish new banking regulatory regimes at the state and international level offer unique opportunities for governments to embed human rights due diligence procedures in the banking sector. Some examples:

- Bank supervision: Requiring banks to adopt human rights standards (as well as broader sustainability-oriented standards) should be a part of bank supervision activities, including the granting of licenses, and the extension of central bank-provided credit and insurance.

- Basel Capital Accord: Banking regulators should mandate the inclusion of human rights and environmental issues into the risk assessment processes for bank financing activities. One possibility is to include such criteria in the Basel Capital Accord's capital adequacy ratios, which are currently being debated.

- Due diligence, screening of customers: Know Your Customer guidelines are anti-money laundering mechanisms used by banks to screen potential depositors. In a similar vein, screening guidelines should be developed for banks to conduct human rights due diligence for both commercial depositors and borrowers, with the aim of barring financial services to corporations, states and other clients that do not respect human rights.

- Transparency: Banking and commercial secrecy practices too often hide banks' complicity in human rights violations. Governments should demand that banks be transparent about their risk assessment processes, internal decision-making procedures, client base, and their transactions. In the light of widespread distrust

[4] A/HRC/11/13, para. 7-11.
[5] A/HRC/8/5, para. 32.

about banks' intentions, the issue is no longer how much transparency one can allow but how much secrecy one can afford. Such transparency is already best practice among some social banks.

- Deal transparency: In particular, banks should be required to publish details of loans they make to governments or state owned companies, as well as central bank accounts that they hold for other countries. Proposed loans should be published in a timely fashion so that the parliament of the recipient country has an opportunity to scrutinise the deal. Banks should also be required to verify use of the loans they make to governments and state-owned companies.

III. Corporate responsibility to respect

In his 2009 report to the Human Rights Council the Special Representative stressed that "the social licence to operate is based on social norms that can be as important to the success of a business as legal norms." He referred to the near-universal recognition of the corporate responsibility to respect human rights, namely "not to infringe on the rights of others".[6]

Civil society has similarly expressed its demand that banks not infringe on the rights of others. In 2003, over 100 civil society groups issued the Collevecchio Declaration, a statement on the role and responsibilities of the financial services sector[7]. One of the six key principles identified in the declaration is "do no harm", which applies to banks' social obligation to respect the rights of others.

A. The state of banks due diligence procedures

According to the Special Representative, in order to fulfil the corporate responsibility to respect "an ongoing process of human rights due diligence (is required), whereby companies become aware of, prevent and mitigate adverse human rights impacts".[8] He further concludes that relatively few companies have systems in place enabling them to demonstrate with any degree of confidence that they respect human rights.

BankTrack's mapping and monitoring of existing bank policies confirms these findings for the financial sector.[9] The "Mind the Gap" report, released by BankTack in December 2007[10], rates the publicly-available lending policies of 45 banks against what is considered best practice for financial institutions based on current tools and international standards. The report found that at the time of release only 12 of these institutions had developed specific human rights policies. Of the 14 sectors and issues reviewed by "Mind the Gap" report, many fall within the broad spectrum of human rights. The report examined bank financing standards related to 'Labour issues', for which four banks had developed specific policies; 'Indigenous peoples', with five banks exhibiting policies and

[6] A/HRC/11/13, para. 46.
[7]www.banktrack.org/download/collevecchio_declaration_with_signatories/030401_collevecchio_declaration_with_signatories.pdf
[8] A/HRC/11/13, para. 49.
[9] *Mind the Gap*, BankTrack, December 2007.
[10] BankTrack is currently producing a updated and expanded report that will be published at the end of the year.

‘Military industry and arms trade’, of which 12 banks had policies. “Mind the Gap” also examined banks’ sector lending policies, including those governing mining, forestry and oil and gas transactions, which pose particularly high human rights risks.

When focusing more specifically on human rights policies the report shows that only one bank of the 45 scored a 3 on a scale of 4. A score of 4 indicates that the bank has set up a screening process for relevant transactions, sectors, and countries; that it requires a meaningful Human Rights Impact Assessment to be done in certain cases, and that it has defined a clear bottom-line regarding the circumstances under which financing will be declined.

A score lower than 3 indicates that a bank would not meet the Special Representative’s expectation of a human rights due diligence procedure. Thirty banks scored 1 out of a possible 4, meaning their policy is vaguely worded or aspirational. For instance, a bank scoring 1 may have endorsed the UN Global Compact or the Universal Declaration of Human Rights, without adding any concrete policies, procedures or standards to implement those commitments. The remaining 15 banks received a 0, meaning that no human rights policy at all was in existence.

B. The scope of due diligence procedures of banks

In his 2009 report to the Human Rights Council the Special Representative explicitly mentioned that when extending project loans, “banks do have human rights due diligence requirements (…), and human rights risks related to the projects are also risks to the banks’ liability and reputation”.[11]

We interpret this paragraph as an example, and not as a statement that banks’ human rights due diligence requirements are limited *only* to project loans. The Special Representative’s report on clarifying the concepts “Sphere of Influence” and “Complicity” implies that banks have a broader responsibility to respect human rights: “(T)he scope of due diligence to meet the corporate responsibility to respect human rights (…) depends on the potential and actual human rights impacts resulting from a company’s business activities and the relationships connected to those activities.”[12]

For example, banks pursuing a holistic human rights policy would want to ensure that they were not providing any form of trade finance to companies trading minerals that were fuelling conflict and human rights abuses. A broad interpretation of the human rights responsibilities of banks would also encompass banks’ other activities beyond providing capital to companies. It would include banks’ own anti-money laundering commitments and policies for example, since banks play a critical role in allowing corrupt government officials to embezzle state funds out of the world’s poorest countries. This looting cannot occur without banks to process the wire transfers or accept the funds, a practice which has a devastating effect on poverty and human rights in those countries. A more broadly-interpreted reading of banks’ human rights responsibilities would also require banks to be transparent about the loans they make to governments or state owned companies, since these loans -- if misappropriated as too often occurs -- result in

[11] A/HRC/11/13, para. 73.
[12] A/HRC/8/16, para. 25.

onerous national debt burdens. Heavy debt burdens have direct economic and social human rights implications for the populations of poor countries, as they reduce access to healthcare and education.

In his 2009 report the Special Representative also emphasised that the inability to control a specific situation is no reason to ignore it.[13] This point is of particular relevance for BankTrack; civil society organisations that confront financial institutions with how their transactions are having a negative impact on human rights are often told that the situation is beyond the control of the bank.

In the 2007 Briefing Paper "Human Rights, Banking Risks" BankTrack outlined the key elements of a human rights (due diligence) approach for banks.[14] One difficulty when dealing with the specific responsibility of a bank is that, depending on the transaction, there are widely differing degrees of involvement and overlapping responsibilities. For example, a bank which provides a loan guarantee may not have as much influence as a bank which provides a direct loan to a client. Similarly, a mining company looking to expand its operations may find that its (bank) financial advisor may be more influential and involved at an earlier stage than one which helps underwrite a bond offering many months later.

To start with the clearest situation, the human rights responsibility of a bank engaging in project finance seems undisputed. Project finance is used in the financing of long-term infrastructure and industrial projects. It is based upon a complex financial structure where project debt and equity are used to finance the project, rather than the balance sheets of project sponsors. Usually, a project financing structure involves a number of equity investors, known as sponsors, as well as a syndicate of banks that provide loans to the operation. The loans are non-recourse loans, which are secured by the project assets and paid entirely from project cash flow, rather than from the general assets of the project sponsors. The non recourse financial structure means that the repayment of the bank loan is tied to the success of one specific project.

This is the reason why banks providing project finance established the Equator Principles, currently the only industry-wide sustainability financing standard.[15] It is important to stress that project finance is a niche market; the impact of the Equator Principles on the overall activities of a bank is therefore limited.[16] Project finance provides well under five percent of capital raised through commercial lending and investment banking and its use is decreasing, due to the high financial risks for the banks associated with that form of financing. Within an individual bank, project finance can represent as little as one or two

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[13] A/HRC/11/13, para. 51.

[14] www.banktrack.org/download/human_rights_banking_risks_incorporating_human_rights_obligations_in_bank_policies/0_1_0_070213_human_rights_banking_rrisks.pdf, p. 16 - 20.

[15] BankTrack has submitted its critique of weakness of human rights considarations and language in the equator principles to the Special Representative (www.banktrack.org/download/the_international_finance_corporation_s_performance_standards_and_the_equator_principles_respecting_human_rights_and_remedying_violations_/0_final_ruggie_submission_august_6_.pdf). BankTrack is committed to participate in the revision of the IFC Performance Standards (which are the basis of the Equator Principles), to help to improve the human rights aspects.

[16] Some banks state that they voluntary apply the Equator Principles to some business areas other than project finance.

percent of overall business; and some Equator signatories (EPFI's) are not involved in project finance at all.

There are a range of situations which in practice are similar to non-recourse project finance. For example, if banks provide capital to a small mining company that operates only a few mines, the link between the bank's financing activities and human rights impacts of the company are straightforward. Banks can provide capital either through commercial banking operations (short term loans, bridge loans, general purpose loans, revolving credit facilities, etc.) or investment banking operations (bond issuance and underwriting, initial public offering, secondary share offerings). In BankTrack's view the responsibility is not determined by the specific activity of the bank, but by the link between the loan or capital raised and the human rights impacts of the companies financed. If banks are acting in syndicates, which is often the case, they share this responsibility.

The indirect but nevertheless very decisive role banks play in such situations is illustrated by the fact that they literally can "pull the plug". If financing is denied or withdrawn, a particular activity or project cannot proceed until another financier steps in. Apart from an on/off situation banks can use human rights-related covenant clauses to demand that a client make changes, for example in the design and execution of a particular project.[17]

We acknowledge that the situation becomes less clear when banks provide capital to a government or large multinational corporation that may violate human rights in some, but not all of their operations. As clients generally cannot guarantee that the capital that banks help raise, or the loans that banks provide, will not support operations where human rights are affected, banks still have human rights due diligence requirements.

The Special Representative mentions in his 2009 report that "beyond banks lies an even more complex array of lenders, investors, and asset managers. Precisely how their respective due diligence differs requires further clarity."[18] BankTrack would welcome efforts to clarify the role of banks in their vastly differing roles and of the financial actors mentioned above, particularly in the Special Representative's 2008 – 2011 workplan.

IV. Access to remedy

In his 2008 report to the Human Rights Council the Special Representative stresses that an "effective grievance mechanism is part of the corporate responsibility to respect".[19] The revised Equator Principles launched in 2006 demand that sponsors of high impact projects establish a grievance mechanism.[20] BankTrack welcomed this as a step in the right direction, but does not consider the establishment of grievance mechanisms by project sponsors as a substitute for mechanisms that provide remedy for negative impacts of bank decisions.

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[17] The Equator Principles have issued a guidance document to EPFIs on Incorporating Environmental and Social Considerations into Loan Documentation, unfortunately it makes no reference to human rights. www.equator-principles.com/documents/EPLoanDocumentGuidance.pdf.
[18] A/HRC/11/13, para. 73.
[19] A/HRC/8/5, para. 93.
[20] www.equator-principles.com/documents/Equator_Principles.pdf, p.4.

In addition to requiring project-level grievance mechanisms, the EPFIs must also establish a system for ensuring that the Equator Principles are being implemented on the ground, that important environmental and social lending conditions are being met, and that the activities banks finance are not causing significant adverse impacts.

As BankTrack has urged in the past,[21] the EPFIs need a process for hearing concerns from affected communities unfiltered through their clients and a mechanism to ensure accountability and consistent adherence to the Equator Principles on the part of all endorsing financial institutions. The problem is not simply that of borrowers abiding by the terms of the covenant, but also of the EPFIs themselves fully implementing and complying with the Equator Principles.

Because of the nature of the Equator Principles, the EPFIs should agree to take a coordinated approach to accountability in order to ensure greater adherence to these commitments. They could do so by establishing a shared accountability mechanism.[22]

BankTrack welcomes the fact that the Special Representative has echoed this call in his 2008 report: "For multi-stakeholder or industry initiatives aiming to advance human rights standards in the practices of their corporate members, a grievance mechanism provides an important check on performance. The same is true for financial institutions seeking to ensure compliance with human rights standards in the conduct of the projects they support. In the absence of an effective grievance mechanism, the credibility of such initiatives and institutions may be questioned."[23]

This discussion note was written and delivered for BankTrack by Dr. Andreas Missbach (Berne Declaration) with additional comments and edits from Michelle Chan (Friends of the Earth), Johan Frijns (BankTrack) and Anthea Lawson (Global Witness).

Dr. Andreas Missbach
Berne Declaration
Private Finance Programme, Joint Managing Director
CH-8026 Zürich/Switzerland
+41 44 277 70 07
andreas.missbach@evb.ch

BankTrack
Vismarkt 15
6511 VJ Nijmegen/Netherlands
+31 24 3249220
coord@banktrack.org
www.banktrack.org

[21] www.banktrack.org/download/no_u_turn_allowed/040120_no_u_turn_allowed.pdf
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[22] www.banktrack.org/download/equator_principles_ii_ngo_comments/0_060428_epii_ngo_position_paper_public_version_final.pdf
[23] A/HRC/8/5, para. 100.