Human rights are Banking risks

Presentation of Dr Andreas Missbach, representing BankTrack at the "Consultation on Human Rights and the Financial Sector". Geneva, February 16th 2007

Civil society has expressed clear expectations regarding financial institutions' role and responsibility regarding human rights. For example, the Collevecchio Declaration, which was launched in 2003 and endorsed by 100 civil society organizations, called on financial institutions to take immediate steps to embrace and implement six commitments as a way for financial institutions to retain their social license to operate. Human rights was one of the central issues singled out in the declaration.

My remarks today will focus on three themes: 1) how banks are linked to human rights violations beyond project finance, 2) banks' influence over clients, and 3) how banks should approach human rights.

First, ***how banks are linked to human rights***

It is very unusual for a bank or other financial institution to be directly involved in Human Rights violations, but they have a special responsibility because of the strategic role that financing plays for their clients. Banks can be complicit by ignoring the human rights violations of clients while providing financial assistance for the client's activities.

This session is entitled "beyond project finance". Let me share a few remarks here about the Equator Principles. Although BankTrack has followed the Equator Principles very closely, we believe the EPs have serious weaknesses, are deeply convinced that many of today's challenges do lie beyond project finance. The Equator Principles and the underlying IFC Performance Standards fall short of international human rights law. 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. Furthermore the Equator Principles lack implementation and accountability systems.

It is definitely not enough for a bank to simply adopt the Equator Principles and think that this will prevent them from being complicit in human rights violations. But the most serious limitations of the principles are the fact that they apply only to project finance.

Banks can and do facilitate rights-violative activities through providing many products and services other than project finance. For example, project finance is not a common method of financing timber, soy, palm oil and other plantations — activities that involve significant land conversion and often negatively affect livelihoods and rights of communities. Project finance is also rarely used to finance controversial weapons production, mercenaries, footwear and apparel manufacturing, as well as 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 some Equator signatories are not involved in project finance at all.

Let me give you a few examples of the human rights implications of banks activities beyond project finance:

The first involves corporate lending and underwriting for Freeport McMoRan. 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. 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 the production. Freeport's aggressive mine expansion was only made possible by a massive capital raising campaign, in which many banks underwrote new equity shares and bonds, and lent hundreds of millions of dollars in general purpose loans. In addition the company relied on bank borrowing as well. 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.

The links between banks an a controversial project are not always as clear as in the Freeport example but nevertheless banks may still be responsible. A second example involves a syndicated general purpose loan to India's state-owned National Hydroelectric Power Corporation (NHPC). An international syndicate of banks provides NHPC with corporate loans that represent about 10 percent of the company's assets. NHPC specializes in developing large, and often politically risky, dam projects. It has a notorious record of providing inadequate compensation to, and violating the rights of, displaced people; and also has a demonstrated history of resorting to repressive means of countering community resistance. Through this general loan, the banks provide indirect financing for specific NHPC dams, including the Indira Sagar and Koel Karo projects, both of which have been associated with human rights violations.

The third example involves a joint venture partnership. When I talk with banks about their responsibility for human rights, I often hear sentences like: “What, do you want us to stop doing business in China”. We are not asking for a general divestment from China but China definitely is a difficult case, as the following example shows. In January 2006 a major bank announced that they signed an agreement with China Poly Group Corporation (Poly) to establish the Poly Finance Company Limited, in which the bank took an equity participation of 15%. This company provides financial management services exclusively to companies of the Poly Group. While announcing the deal, the bank failed to disclose two important pieces of information: First, Poly has been described as «the People’s Liberation Army commercial arm” and second, a recent report by Amnesty International mentions Poly as “one of the largest Chinese arms exporting companies”. Among Poly's biggest current arms customers are countries as Burma, Iran and Pakistan. Since Poly Finance was set up to manage and possibly raise capital for the businesses of the Poly Group, how is the bank involved to ensure that their money and services are not going to be used to facilitate arms sales to Burma’s dictators or other activities with questionable human rights impacts?

This brings me to my second theme, ***banks’ influence over clients.***

BankTrack argues that all of a bank’s clients and business partners are within their sphere of influence. But we also acknowledge that their level of influence over their clients or business partners varies according to the different services the banks provide. They therefore have a differentiated responsibility.

In project finance, and all commercial and investment banking activities where financiers know or could know for which specific project the money is raised (as in the example of Freeport),, financial institutions can integrate a strong set of human rights standards in their financial risk assessments. The project’s human rights impact can be an important factor in deciding whether to lend money to a specific company or for a specific activity. Financial advisors and lenders can also require or encourage clients to ensure respect for the international human rights law through loan covenants.

When providing products and services for general purposes, a due dilligence must include analysis of the human rights record of the client. Banks should analyze the human rights risks of the particular client, including proven or alleged human rights violations, and the client's overall human rights record to determine whether there is a systemic problem with human rights violations.

Banks that provide investment funds or asset management services can use their shareholder and/or voting rights to advance human rights policies in the companies they own. They can include human rights in their financial analysis, or exclude investing in specific types of securities Furthermore, they can require vendors such as researchers, sub-advisors or brokers include stringent human rights analysis in their services.

Banks' responsibility and sphere of influence does not stop at the pre-financing phase. After they provide financing, they should continue to observe the activities of the clients regarding human rights. Their monitoring activities should not solely rely on what clients tell them; rather, FIs should establish a channel of communication with local people and other stakeholders so they can receive alerts about potential human rights problems with a client or project. If Banks find out or are informed that a client may be violating human rights standards they should use their influence over the project or client to advocate for remedial measures. Ultimately, to avoid complicity a Bank may need to sever relationships with clients that demonstrate a lack of willingness or ability to respect the human rights standards.

Finally, let me end with a few words on ***how banks should approach human rights.***

Currently, only a small group of banks have voluntarily developed their own social and human rights policies and procedures. The few policies that exist generally are not robust, nor do they prevent financiers from being complicit in human rights violations. BankTrack is urging banks to make their human rights policy more detailed, and to understand and define their levels of influence given the various types of financial products and services they offer, and with regard to their relationships with clients. In the position paper that was distributed we give some more elements of a comprehensive human rights approach for banks.

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 strongly encourage you Mr. Ruggie 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.

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