The OECD Roundtable on Corporate Responsibility 2007

The OECD Guidelines for Multinational Enterprises and the Financial Sector: The Supporting Role of the OECD Guidelines

Introduction

OECD Watch and the Brotherhood of St Laurence welcome the opportunity to participate in the OECD Annual Roundtable on Corporate Responsibility. This year's theme—the OECD Guidelines for Multinational Enterprises and the Financial Sector—is both timely and necessary. This response supports the preliminary observations raised by OECD Watch at the March 2007 Investment Committee Consultation.

The current global interest in socially responsible investment, more engaged capital markets, the development of mechanisms such as the Equator Principles, United Nations Principles for Responsible Investment, recognition by some financial institutions of their sphere of influence, and the expressed views of some NCPs clearly confirms the community expectation that the finance sector should be subject to the same corporate accountability framework and principles as other enterprises engaged in cross border activity.

The significant influence that the finance sector, including, *inter alia*, investment funds (superannuation, insurance, private equity), capital, project and debt financing, play in the global economy is well documented. However, the contribution of the financial sector via funds and services is not always positive, accountable, transparent or in accordance with the principles of corporate social responsibility, domestic and international law. It is important to recognize the influence of the finance sector beyond their immediate activities, and to ensure adequate safeguards are in place to protect human rights, ensure equitable access to services, accommodate religious diversity, ensure sufficient credits to the rural sector and small enterprises, provide a stable and enabling macroeconomic environment and ensure fair and reasonable treatment of employees.

The responsibility of the finance sector to uphold the OECD Guidelines has come to the fore in recent specific instances. The handling of these cases by some National Contact Points has further revealed inconsistencies in both interpretation of the Guidelines and capacity and willingness to implement the complaint mechanism in complex cases involving the finance sector.

The March 2007 Investment Committee Consultation confirmed that all stakeholders recognised the need for informed, open and rigorous discussion of the challenges, opportunities and complexities of applying the Guidelines to the finance sector. It is clearly established that the OECD Guidelines were developed to encourage corporate responsibility and have broad application to both trade and investment. Any attempt to mimimise their reach—to either sectors of industry or countries of operation—will significantly undermine their purpose and support, and be viewed as unnecessarily restrictive.

Given there is no sound reason to exclude the finance sector from consideration under the OECD Guidelines for Multinational Enterprises, comments in this response will focus on possible criteria for admissibility as a specific instance and questions posed in the Roundtable programme with regard to the supporting role of the guidelines.

This response makes the following key points:

- The applicability of the Guidelines to the finance sector is without contest
- In the absence of binding corporate responsibility regulation the challenge is to ensure OECD government and non-adhering country signatories to the OECD Guidelines demonstrate the required ‘political will’ to effectively and consistently use the specific instance complaint mechanism
- Similarities between the application of the Guidelines to the investment chain and the supply chain clearly exist. There is a view that investment and financial services may have an even greater capacity to influence—via capital (and therefore greater responsibility) than manufacturing or resource–based industries[1] thus making the applicability of the Guidelines even clearer. However, it is also important to note the ability of ‘buyers’ to influence the production process, price and delivery time of goods and as such, exert financial authority as a buyer
- Experience has shown that an incremental approach to corporate responsibility has the greatest ‘take-up’ amongst enterprises. As such, it makes sense for governments to actively promote the Guidelines and encourage accountability, first and foremost, amongst those financial institutions with the greatest ability to influence, i.e. the investment banks, private equity firms and superannuation and pension funds. These are the financial entities with the greatest ability to influence and the most extensive global reach; and
- The sphere of influence and boundaries of responsibility of the finance sector requires consideration but must not be used to limit the scope or intent of the Guidelines.

1. Applicability of the Guidelines

Are the OECD Guidelines for Multinational Enterprises a useful tool for governments to communicate corporate responsibility expectations to the financial sector?

Clearly the answer is yes. The OECD Guidelines are the best existing multilateral mechanism to promote corporate accountability and sustainable development. The Guidelines and their unique complaint mechanism were developed to have broad application to both trade and investment, and therefore have direct applicability to the finance sector.

The Guidelines provide a mechanism through which governments can urge companies to embrace ethical business practices, and opportunities for the finance sector to contribute to sustainable development.

Whilst the applicability of the Guidelines to the finance sector is not debated, their usefulness as a tool for Governments to promote corporate responsibility is dependent on host country ‘political will’ and the willingness of National Contact Points (NCPs) to undertake active promotion, effective implementation and move towards functional equivalence in the handling of specific instances. Inconsistent interpretation and constant clarification of the Guidelines by governments, via the NCPs, is the most significant limiting factor in the effectiveness of the Guidelines, not the Guidelines themselves. This remains a critical challenge for the Investment Committee.

[1] Bruno Lamborghini, Chairman, Olivetti Lexicon S.P.A

2. Guidelines provisions

What provisions in the text of the Guidelines are most potentially relevant for financial institutions?

The short answer is all of them, depending on the circumstances and activities of the enterprise. However, a critical issue for the finance sector is that of disclosure. Chapter three of the Guidelines, Disclosure, makes several references to 'business activities', 'business lines or geographic areas', 'non-financial information including environmental and social reporting', 'material issues regarding employees and other stakeholders', and 'managing risk'. The Commentary goes further,

> '[e]ncouraging a second set of disclosure or communication practices in areas where reporting is still emerging such as, for example, social, environmental, and risk reporting'.[2]

The intent is to clearly encourage disclosure of the effects of investment activity on society and the environment. The background paper developed by Oxford Business Knowledge makes reference to growing disclosure trends such as social, environmental and governance disclosure and the 'comply or explain' approach required by signatories to the UN PRI.

> 'Recent work on socially responsible investment (SRI) has increasingly focused on the non-ethical aspects of SRI, and has instead incorporated corporate governance criteria. The new approach to SRI among institutional investors such as pension funds is motivated by mounting evidence that social, environmental and corporate governance (ESG) factors affect a firm's long-run specific and non-diversifiable risks.'[3]

The UN PRI 'comply or explain approach' requires signatories to report on how they implement the Principles, or provide an explanation where they do not comply. In Australia, two recent Government inquiries into CSR[4] made specific recommendations on disclosure, particularly with regard to the disclosure of risk including an 'if not, why not' reporting function on compliance with good business conduct.

> 'The [Australian Labour Party] Committee members recommend an amendment to the Corporations Act 2001 to require all public and private companies, operating in Australia and above a specified size threshold, to publicly disclose their top five sustainability risks and their strategies to manage such risks. This provision should be subject to an 'if not, why not' flexibility mechanism modelled on that contained in the Australian Stock Exchange Corporate Governance Council's Principles of Good Corporate Governance'[5]

The European Parliament's recently adopted resolution (March, 2007)—*Corporate Social Responsibility: a new partnership*— 'calls on the European Commission to develop mandatory reporting which will hold corporations legally accountable to respect the human and worker rights and the environment in their international supply chains'. Similarly, there is growing international

---

[2] OECD Guidelines for Multinational Enterprises Text Commentary and Clarifications
[3] Oxford Business Knowledge, Recent Trends and Regulatory Implications in Socially Responsible Investment for Pension Funds, 2006
[4] The Corporations and Markets Advisory Committee (CAMAC) reference on Corporate Social Responsibility, 2006, and the Parliamentary Joint Committee on Corporations and Financial Services Inquiry into Corporate Responsibility, 2006
[5] Recommendation 10, Parliamentary Joint Committee on Corporations and Financial Services inquiry into Corporate Responsibility, Supplementary Report by labour members, 2006

recognition of the Global Reporting Initiative (GRI) as the leading frame of reference for social and environmental reporting. A study by the GRI in 2002 confirmed the relevance of many of the OECD Guidelines provisions to the GRI reporting framework. This suggests that although the Commentary of the Guidelines states that social and environmental reporting is still emerging, there is increasing harmonisation in this area, and a certain level of standardisation in reporting has emerged since the latest review in 2000.

Disclosure is clearly an important and emerging expectation with regards to corporate responsibility. On a cautionary note, whilst disclosure is an essential first step for enterprises to give consideration to the effect of their investment practices, and to harness a response, disclosure alone is not enough for an enterprise to claim they are upholding the principles of the OECD Guidelines. The real test comes in how an enterprise responds to an identified negative impact of their business activity, or more importantly, how they guard against such practices, investments and relationships in the first place. Companies need to disclose and define (for the public record) their good business conduct implementation plan and boundaries or parameters within which they are prepared to do business.

An additional disclosure consideration is that of market value. Whilst there is growing interest in ESG reporting, the market does not yet value this. This makes it difficult at times to argue the business case for CSR as it is not currently being reflected in the share price of listed companies. Greater market impact can be seen with exposure of breaches of internationally recognised laws and principles.[6]

3. Investment chain and business relations considerations—sphere of influence and complicity

How can the OECD Guidelines assist financial institutions in promoting responsible behaviour in their relations with business partners?

For the purposes of this discussion the finance sector can be generally defined as:

> A multinational enterprise that contributes to, or participate in, international investments and financing, either directly or indirectly, through financial capital, services and expertise. It could apply *inter alia* to banks, investment funds, institutional investors (superannuation and pension), asset owners, asset managers, project financing, consolidated loans and debt financing and insurance. The business relationships could be constructed in a variety of ways including, joint ventures, public private partnerships, listed companies, private equity consortiums, corporate bonds and many others.

The Guidelines provide a clear set of principles that will assist the financial sector in implementing responsible business practices throughout their own entities and amongst entities and business relations they control or influence. The complexity lies in defining ‘control and influence’— the sphere of influence and boundaries of responsibility. The fundamental question is where in the sand is the appropriate place to draw a line of responsibility and assess who is most accountable? In this context, the OECD Investment Committee and NCPs are well placed to contribute to current discussion and thinking. For example, the Global Reporting Initiative is giving consideration to ‘boundaries of responsibility’ with regard to reporting, and John Ruggie’s work as Special Representative to the United Nations Secretary General includes the issues of ‘sphere of influence’ and ‘complicity’. This clearly demonstrates the importance of these factors.

[6] Conversation between Serena Lillywhite, Brotherhood of St Laurence and a major Australian fund manager, 25 May, 2007.

The presentation by Mr. Lennart Killander-Larsson[7] has provided a considered contribution to this year's roundtable. OECD watch would like to acknowledge and thank him for that. He has discussed, to some extent, the concepts of sphere of influence and complicity. He correctly makes the connections between supply chain and investment chain responsibility and suggests the upholding of human rights principles and norms as possible criteria to exert influence.

In this context, how can the Guidelines assist financial institutions? In the first instance, the OECD Guidelines can be used as a risk awareness tool. The provisions themselves give guidance on the critical issues. However, it is important to recognise that all financial institutions have the primary goals of profitability, maximising share holder returns and fiduciary responsibility. Similarly, the very nature of certain financial institutions—such as private equity—with their typical 3-5 year horizon, may compromise sound corporate accountability practices which embody transparency and disclosure, human capital development and stakeholder engagement. Further, a "culture prevails whereby fund managers are convinced they can beat the market rather than grow the market"[8] through sustainable economic growth that values safe and healthy communities and environmental protection. None-the-less, examples of the effective use of the Guidelines as a corporate accountability tool do exist and can be learnt from.

The Council on Ethics for the Norwegian Pension Fund effectively uses the OECD Guidelines for Multinational Enterprises (as well as the UN Global Compact and the OECD Principles of Corporate Governance) to assess if companies are involved in acts or omissions in conflict with ethical guidelines. The purpose is to:

- Exercise ownership rights in order to promote long-term financial returns and sustainable development
- Undertake negative screening of companies from the investment universe that either themselves or through their entities they control; and
- Exclude companies from the investment universe because of acts or omissions that constitute an unacceptable risk that the fund contributes to unethical acts or omissions such as violations of fundamental humanitarian principle, serious violations of human rights, gross corruption or severe environmental damage[9].

There are also examples of enterprises that are actively using the OECD Guidelines against which to 'scan' their business activities and relationships to identify aspects that are at risk of non-compliance with the Guidelines. A major Australian bank has recently undertaken such a process with the assistance of an independent consultant. This bank is currently giving consideration to public disclosure of identified risks. Interestingly, this is the same bank which the Australian Conservation Foundation attempted to use the specific instance mechanism against for their funding activities and relationship with a Malaysian logging company with a well documented history of human rights abuse and environmental degradation. This particular case highlighted, among other things, the NCP's inability to ascertain the degree of influence the bank may have had over its client. The case, whilst not accepted as a specific instance, has focused the institution's attention on the Guidelines as a risk assessment tool and is currently developing human rights policies.

---

[7] Chair, Swedish National Contact Point. Presentation to the 2007 OECD Roundtable on Corporate Responsibility: The OECD Guidelines and the Financial Sector, Paris.
[8] Charles Berger, Australian Conservation Foundation, presentation, Melbourne, May, 2007
[9] Annual Report 2006 , Council on Ethics for the Norwegian Government Pension Fund - Global, p.75

The rapid increase and 'mainstreaming' of private equity in the finance sector is significant with regards to the OECD Guidelines. These are private companies that by their very nature tend to obscure, with little or no accountability or transparency. Despite this, private equity managers need to be just as accountable as managers of listed financial institutions. 'Private equity now accounts for 1 trillion dollars globally and is unashamedly dedicated to the pursuit of profit. In 20 years time private equity may exceed public equity in terms of a 'pool of capital', making it significant in the finance sector'[10]. In this context asset ownership versus asset management is important. At a recent seminar in Melbourne on private equity and CSR, the point was made that "no one's ever washed a rented car'.[11]

The complexity of the investment universe is such that the criteria of majority share ownership, alone, is inadequate in determining who has greatest responsibility and the boundaries of that responsibility. A more realistic assessment of the sphere of influence could include the following admissibility criteria, dependant on the nature of the business:

- Does the financial institution own or manage the asset?
- Does the financial institution have the ability to influence ownership rights or investor duties (e.g. via superannuation and pension funds)?
- Is the financial institution the principle or primary provider of capital or financial services?
- Does the financial institution have the ability to influence contractual arrangements (thereby 'screening out' adverse activities or 'screening in' partners and /or projects that uphold the Guidelines)?
- Is the financial institution providing capital funds, and / or financial services, that contribute to unethical acts or omissions (e.g. the Council on Ethics for the Norwegian Government pension Fund-Global)?
- Is the financial enterprise participating in, facilitating, authorising, tolerating or knowingly ignoring activities by others (a state, rebel group, another company or individual) that would make them complicit in unethical businesses practices and fundamental ethics norms?
- How long has the business relationship existed (it can be argued that the longer the duration of the business relationship or the earlier a financial institution commits to a proposed project, the greater their ability and responsibility is to exert influence on day-to-day operations and outcomes)?
- Does the enterprise being funded / assisted by the financial institution systematically and repeatedly engage in activities that compromise workers rights, ignore local communities concerns and damage the environment?
- Is the financial institution a signatory to the Equator Principles and thereby financing and exerting influence on major projects with a budget in excess of USD 10 million?

Whilst this suggest that exercising ownership rights and investment duties is critical, an over emphasis on majority ownership and identifying the principle or primary financiers has associated risks. For example, managers may seek to structure their activities in such a way (e.g. minimize their level of influence and business relationship structures) to avoid an 'influencing relationship' and therefore accountability for operations and obligations under the OECD Guidelines. In addition, there are numerous circumstances where a financial institution may not have control, or even influence, but they still have the capacity to make a business or investment decision based on 'what's right' to uphold fundamental ethical norms. The Australian National Contact Point statement with regard to the aforementioned

[10] ANZ Bank, ACCSR seminar, 'The Effect of Private Equity Takeovers on CSR", Melbourne, May, 2007
[11] Phil Spathis, Australian Council of Superannuation Investors ,presentation, Melbourne, May, 2007

Australian Conservation Foundation (ACF) / ANZ issue claimed that the ANZ Bank had limited influence and if they withdrew other less scrupulous financiers would step in. However, as the ACF points out:

> 'A violation of human rights, for example, can not be justified (under the Guidelines or under any conventional theory of ethics) on the basis that others are doing the same, or would do the same if they had the chance. The Guidelines override such perverse pragmatism by specifying minimum levels of acceptable conduct, regardless of the competitive advantage'.[12]

Clearly, all enterprises have the scope and capacity to make decisions on what activities they will undertake and who their business partners are. Just as assessments are made with regard to profit maximization and fiduciary responsibility, financial institutions must undertake an assessment of the impact of their business and network of relationships on the community, workers and the environment to uphold fundamental ethics norms

Attempts by NCPs to reject specific instances involving the finance sector based on, for example, a narrow interpretation of the 'investment nexus' or other potentially limiting factors such as 'residual risk bearing', 'fee for service' or others, is detrimental to the effective implementation of the Guidelines. It may simply encourage parts of the financial sector to act with reckless disregard for the consequences of their decisions in the mistaken belief that they have no obligations under the OECD Guidelines. Clearly, NCPs should take the highest available and commonly accepted standards when assessing the responsibilities of financial institutions for the behaviour of the companies they finance.

So the question remains who should be held most responsible in the finance sector for upholding the OECD Guidelines principles of business conduct and why? As previously stated the Guidelines apply to all enterprises engaged in cross border trade and investment and as such none are exempt. However, given the importance of 'sphere of influence' and 'complicity' in considering admissibility as a specific instance, it follows that NCPs would make a significant contribution to The OECD Guidelines for Multinational Enterprises if they were actively promoted (and investigated through the specific instance mechanism as required) to those financial institutions that have the ability to exert greatest influence, that is:

- Investment banks
- Private equity consortiums
- Superannuation and pension funds

These institutions have the greatest ability to influence. They are the 'financial conductors'— they put together the deals, finance the deals, and profit from them. They are often the primary or principal providers of financial capital and services, even when structured through private equity consortiums. In addition, they have the greatest global reach and as such are most likely to be operating in emerging economies or conflict zones that may not have adequate regulatory frameworks. Their frequent participation in large scale infrastructure projects, often through public private partnerships, gives them scope and opportunity to influence political end economic outcomes and processes. Such projects have a direct impact on human rights, labour, the environment, and local communities and therefore, they have an overriding responsibility to use their influence to ensure acceptable standards of business conduct, and compliance with domestic and international law.

---

[12] Supplementary submission of the complainants regarding investment nexus issues arising in ANZ specific instance under the OECD Guidelines, 14 September, 2006. P. 3

4. Effective use of the specific instance complaint mechanism

What is the potential value to financial institutions of the non-adversial approach to dispute resolution embodied in the 'specific instances' facility offered by NCP's?

The 'specific instance' complaint mechanism is a unique feature of the OECD Guidelines, and one that contributes to the current acceptance of the Guidelines as an important CSR tool. This mechanism can:

- Provide a forum for engagement that can form the basis of ongoing dialogue
- Contribute to building trust among parties
- Improve transparency and accountability through final statements being in the public domain
- Provide a forum to hear the voice of those individuals or communities adversely affected by enterprise activity
- Improve understanding of the complexities of international business
- Provide an affordable process to raise concerns
- Contribute to global understanding of the positive and adverse impact that international investment and business activity can have
- Impact on enterprise reputation

There are a small number of cases, such as the highly sensitive GSL (Australia) case, where the mechanism has been used effectively and a beneficial outcome was mediated with the assistance of the NCP. However, OECD Watch has been actively testing the Guidelines since the 2000 Review and this has revealed considerable inconsistencies. The OECD Watch 2005 publication, *Five Years on: a Review of the OECD Guidelines and National Contact Points* demonstrated that the complaint mechanism, and therefore the Guidelines, is only useful as a CSR tool when used consistently and effectively by the National Contact Points. This requires 'political will' on the part of signatory governments and willingness by NCPs to actively and meaningfully apply the specific instance process. Consideration of 'precedents' set by other NCPs would be beneficial.

Recent cases in the finance sector demonstrate the absence of functional equivalence among NCP's and the impact this has on the specific instance process. For example, the Australian NCP decision to reject a case against a major Australian bank appears to be out-of-step with the interpretation by other NCP's. For example, the Belgian NCP accepted a complaint against several banks that have provided finance for the Baku-Tbilisi-Ceyhan pipeline, and the Swedish NCP accepted a complaint involving a pulp mill in Uruguay. The latter case involved the Finish, Swedish and Norwegian NCPs. The Finnish NCP chose to reject the case, the Swedish NCP accepted it and the Norwegian is pending.

The Guidelines dispute resolution mechanism has the capacity to impact (both positively and negatively) on the reputation of an enterprise. Whilst this may take a long time to show up in the financial markets it can be powerful. As the Australian Conservation Foundation notes:

> 'The Guidelines, like many voluntary corporate standards, can have a powerful influence over time even if the immediate effect of any one company's decision to improve standards is a short-term shift by some customers to a less ethical business partner'
>
> 'Over the medium-to-long term, the progressive extension of voluntary standards puts strong pressure on non-adhering businesses, both by restricting the pool of those willing to do

business with them and by empowering communities with examples of commercially viable, responsible business conduct'.[13]

The Procedural guidance for NCPs and the Investment Committee contained in the Guidelines commentary lacks the necessary detail to ensure greater functional equivalence and effectiveness amongst NCPs. Clearly this is required if the full potential of the non-adversial approach to dispute resolution embodied in the specific instance mechanism is to be realised.

OECD Watch has made a significant contribution to this with the development of the 'Model European NCP', funded by the European Commission and launched at the OECD Watch Roundtable in Brussels, June 15, 2007. In addition to the development of the Model NCP and three roundtable dialogues throughout Europe (well attended by NCPs and representatives of the OECD), the EU-funded project, in partnership with EUROSIF, also aims to promote the use of the OECD Guidelines among socially responsible investors. In this context, OECD Watch will develop four fact sheets that outline how investors and ethical ranking and rating agencies can effectively use the OECD Guidelines.

The first in this series, *'Making Use of the OECD Guidelines for Multinational Enterprises'* is available today. The following three will be produced in the coming four months. While the project specifically addresses the SRI agencies, these fact sheets will benefit the entire investment community. Our intention, of course, is that socially responsible investment becomes the norm, not the exception.

For further information regarding this submission, please contact

Serena Lillywhite
Manager, Ethical Business
Brotherhood of St Laurence
67 Brunswick Street
Fitzroy, Vic. 3065
Australia

Ph: +61 3 9483 1379
E-mail: slillywhite@bsl.org.au

[13] Supplementary submission of the parties regarding investment nexus issues arising in ANZ specific instance under the OECD Guidelines, 14 September, 2006. P. 3