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OECD Watch Submission to the OECD Investment Committee

Effective application of the OECD Guidelines to the financial sector

March 23, 2009

Submission by OECD Watch to the Investment Committee in preparation to the IC Working Party meetings on the 23rd and 24th of March on the Application of the OECD MNE Guidelines to the Financial Sector, Item 4.a of ICWP Agenda DAF/INV/WP(2009)1

OECD Watch welcomes the decision of the Working Party of Investment Committee to continue its reflection on the application of the OECD Guidelines to the financial sector. The importance of inviting experts from the financial and investment sector to contribute to this debate is acknowledged. However, OECD Watch wishes to express its concern and disappointment over the fact that no consultations with TUAC, BIAC and OECD Watch are planned.

At this time of economic turbulance, OECD Secretary General Angel Gurria, speaking at the G7 Finance Ministers Dinner this February on the need for global ethical standards, confirmed the need for "enhanced engagement", "forging consensus", "coherence" and concern for "emerging and developing countries".[1] OECD Watch, which provides a valuable perspective from civil society organizations around the world representing thousands of consumers and citizens, including many from developing countries, stands ready to contribute.

In light of the global economic crisis, the discussion provides a critical opportunity to address two fundamental issues related to a financial institution's own behaviour and its influence and impact on business partners:

1. How the OECD Guidelines and related instruments might be applied more effectively to the financial sector to improve trust, transparency and accountability; and

2. How the operations of the financial sector can be made more responsible across their global operations, including with respect to their choice of partners and clients, and provision of financial products and services.

I Effective application of the OECD Guidelines to the financial sector

The financial crisis has shown that banks and other financial institutions have failed to perform their basic services in a responsible manner. The OECD Guidelines for MNEs, frequently cited by OECD and adhering Governments as one of their key tools to promote responsible business conduct,[2] have not been effective in preventing the financial sector from such behaviour.

The social cost has been enormous. In this light, OECD Watch believes the application of the OECD Guidelines to the financial sector must be strengthened to redress some of the policy failures highlighted by the current financial and economic crisis. The application must not be limited to the question of influence on clients and business partners alone, but must encompass the business practices and operations of the financial institutions themselves.

The OECD Secretary General astutely observed in a recent speech[3] that apart from the massive regulatory, supervisory, corporate governance and risk management failures that led to the crisis, questions have emerged regarding "honesty, propriety and transparency in business conduct". If the OECD Guidelines for

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[1] Speech by Angel Gurría, at the G7 Finance Ministers Dinner, 13th of February, 2009, Rome
[2] See for example the recent White paper of the Norwegian Government (http://www.regjeringen.no/pages/2146192/PDFS/STM200820090010000DDDPDFS.pdf)
[3] Speech by Angel Gurría, at the G7 Finance Ministers Dinner, 13th of February, 2009, Rome

MNEs are indentified as one of the instruments that should contribute to the restoration of societal trust and confidence in financial systems, their shortcomings in ensuring responsible banking practices must be reviewed.

The current content and implementation of the OECD Guidelines does not engender adequate trust and confidence in financial markets. For the Guidelines to become a useful "brick" of a "Global Standard"[4] they will need to be updated and upgraded, with more stringent implementation and a strong and unified monitoring and review mechanism to improve the functioning and mandate of NCPs.

The financial crisis has clearly demonstrated the need for transparency and effective oversight to ensure that the short term profit motive of companies is balanced by a regulatory framework favoring long term, sustainable business practices.

An unexpected benefit of the global financial crisis may well be the recognition that governments must play a greater role in ensuring the regulatory framework is adequate to protect against the adverse impacts of poor corporate practice, and in particular, irresponsible lending practices. Government responsibility here has only been increased by the massive commitments of taxpayer funds to bail out much of the private sector.

Undoubtedly, much needs to be done on a global scale to address issues such as responsible lending practices, regulating consumer credit, and margin lending. However, it is important that any regulatory changes do not negatively impact the most disadvantaged. For example, there must be safeguards to ensure access to affordable, efficient and reliable financial products and services—including financial literacy training. Global remittance mechanisms for migrant and seasonal workers must not be constrained, and the importance of microfinance initiatives in poverty alleviation must not be overlooked or undermined. We need an economic recovery that is early, equitable and sustainable.

II Influence of financial institutions over business partners

The causes of the present economic crisis lie in the regulatory and corporate governance failures in the financial sector, and failures in regulatory oversight, clearly demonstrating the influence financial institutions have on global economic stability and the adverse impact that poor business conduct can have on the livelihoods of billions around the planet.

Efforts to improve global frameworks for responsible business must include mechanisms to harness the influence of financial institutions. To achieve sustainable business objectives, financial institutions must be promoted and regulated as key *drivers for change* towards sustainable investment, consumption and production. This will include exercising ownership rights in order to promote long-term financial returns and sustainable business practices among clients and business relations.

Further, governments must address their responsibility to uphold adherence to the OECD Guidelines among banks and financial institutions they have nationalised or supported throughout this financial crisis. They must ensure they are not investing in, 'bailing out' or providing loans to corporations in violation of the Guidelines.

Policy makers have a critical role in establishing a new financial regulatory regime that proactively stimulates the transition of the current economic order into a more sustainable system. For example, Know Your Customer (KYC) guidelines (anti-money laundering mechanisms used by banks to screen potential depositors) should be expanded to include social and environmental standards. This would require financial institutions to conduct social and environmental due diligence for both commercial depositors and borrowers, with the aim of prohibiting lending to corporations that do not comply with basic social and environmental standards such as the OECD Guidelines. [5]

In 2007 OECD Watch and the Brotherhood of St Laurence published a briefing paper entitled "The OECD Guidelines for Multinational Enterprises and the Financial Sector: The Supporting Role of the OECD Guidelines" as part of its submission to the 2007 Roundtable. OECD Watch welcomes the decision by the Working Party of the Investment Committee to consider the OECD Watch criteria to assess the influence a financial institution may have, (depending on the nature) on its business relations.

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[4] Speech by Angel Gurría, at the G7 Finance Ministers Dinner, 13th of February, 2009, Rome
[5] See statement from BankTrack "Bank to the Future", El Estorial Statement on Banks and the Financial Crisis, November 6, 2008.

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There is a clear need for the Investment Committee to identify criteria that can be used by NCPs to assess the degree of influence that multinational financial institutions may exercise in their business relations in order to determine the admissibility of specific instances. The diversity of various categories of financial institutions should not be used as an excuse to abstain from any further development of criteria to assess the degree of influence that financial institutions may have over the companies with which they engage. A further specification for various categories may be useful, on the basis of a general set of guiding questions.

If the OECD Guidelines are to be considered a credible, legitimate and enforceable standard of business behaviour, greater conformity and coherence in the assessment of admissibility by NCPs of specific instances involving financial institutions is needed. Investors, in particular representatives of the SRI community, have shown an interest in the OECD Guidelines as a unique potential channel for exploring concrete issues of business ethics influencing investment decisions. SRI specialists that were consulted, suggested that the current way in which the OECD Guidelines are being implemented through the NCPs, particularly the wide disparity in specific instance procedures, inhibits their usefulness as a basis for responsible investment. Consistency and clarity in the admissibility of specific instances would enhance the OECD Guidelines' usefulness in guiding the investment decisions of responsible investors.

OECD Watch has reviewed the criteria developed for the 2007 Roundtable (see Annex 1) and considers them to be a robust and useful set of questions to assist NCPs in their determination. In light of recent global events and statements by the OECD Secretary-General, six additional questions are proposed for consideration:

1. Is the financial institution a signatory to the UNPRI and thereby committed to responsible investment? If so, the financial institution can be expected to have implemented the UNPRI principles in its global operations, choice of partners and clients, and provision of financial products and services
2. Is the financial institution providing capital funds and/or financial services to a project or client located in a country known for poor labour practices, human rights abuses, and / or poor environmental impact regulation?
3. Has the financial institution established a credible mechanism for stakeholder consultation as part of a formalised due diligence and governance framework?
4. Is the provision of financial support linked to government funded export credit, finance and insurance, investment promotion or guarantee programs (responsible business standards and influence must apply to both government and multinational enterprise activity)? If so, is there a requirement to be aware of and apply the OECD Guidelines?
5. Has the financial institution undertaken meaningful due diligence of both commercial depositors and borrowers with regard to social and environmental impact, and has this influenced institutions lending practices?
6. Does the financial institution have transparent corporate responsibility policies, and does it report on non-financial performance using the Global Reporting Initiative (GRI) or other framework?

With regard to 'sphere of influence', Special Representative of the UN Secretary-General on business & human rights Professor John Ruggie suggests the "scope of due diligence to meet corporate responsibility…depends on the potential and actual [human rights] impacts resulting from a company's business activities and the relationships connected to those activities"[6]. In this context, OECD Watch recommends that once established that a financial institution, through its business activities and relationships, has both the potential and actual capacity to influence, that financial institution should then exercise its influence to uphold responsible business practice.

Professor Ruggie further notes that "the relationship between complicity and due diligence is clear and compelling: companies can avoid complicity by employing…due diligence processes…- which, as noted, apply not only to their own activities but also to the relationships connected with them."[7] Sustainability indicators, based on the OECD Guidelines should therefore be integrated into all due diligence and risk assessment mechanisms of financial institutions.

[6] Special Representative of the UN Secretary-General on business & human rights, Professor Ruggie, J (2008) 'Protect, Respect and Remedy: a Framework for Business and Human Rights', paragraph 72, p.20.
[7] Ibid, paragraph 81

Financial institutions and investors are recommended to use the "Fact Sheets for Socially Responsible Investment" developed by OECD Watch and Eurosif[8]. Drawing upon the standards included in the OECD Guidelines, the fact sheets present key questions for assessing adherence to the various chapters of the OECD Guidelines, with two fact sheets specifically addressing two key principles in the Guidelines on human rights and supply chain relations.

To conclude, in light of the current crisis and the recent words by the Secretary-General, OECD Watch calls on the Investment Committee to announce a review of the OECD Guidelines for Multinational Enterprises and to begin discussing the scope, conditions and timeline of the process. The review must be a transparent and inclusive process involving NGOs, BIAC and TUAC on an equal footing and would ideally involve wider consultation. It should take into account the recent developments in the global economy and consider what needs to be improved for more stringent implementation and effective application of the OECD Guidelines to all MNEs, including those in the financial sector.

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[8] OECD Watch and Eurosif partnered to develop a series of four fact sheets to help investors and SRI agencies better understand the scope of the Guidelines and facilitate their use. All four fact sheets can be downloaded from the OECD Watch website:
1 http://oecdwatch.org/publications-en/Publication_2241/
2 http://oecdwatch.org/publications-en/Publication_2239/
3 http://oecdwatch.org/publications-en/Publication_2402/
4 http://oecdwatch.org/publications-en/Publication_3010/

Annex 1

1.1. Criteria for Assessing the Sphere of Influence and business conduct of Financial Institutions

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[9]:

1. Does the financial institution own or manage the asset?
2. Does the financial institution have the ability to influence ownership rights or investor duties (e.g. via superannuation and pension funds)?
3. Is the financial institution the principle or primary provider of capital or financial services?
4. 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)?
5. 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)?
6. 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?
7. 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)?
8. 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?
9. 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?
10. Is the financial institution providing capital funds and/or financial services to a project or client located in a country known for poor labour practices, human rights abuses, and / or poor environmental impact regulation?
11. Has the financial institution established a credible mechanism for stakeholder consultation as part of a formalised due diligence and governance framework?
12. Is the provision of financial support linked to government funded export credit, finance and insurance, investment promotion or guarantee programs (responsible business standards and influence must apply to both government and multinational enterprise activity)?
13. Has the financial institution undertaken meaningful due diligence of both commercial depositors and borrowers with regard to social and environmental impact, and has this influenced institutions lending practices?

[9] Extract from OECD Watch submission to the 2007 OECD Corporate Responsibility Roundtable, authored by Brotherhood of St Laurence, Australia. Criteria 10-15 developed by OECD Watch for discussion by the Working Party of the Investment Committee meeting, March 24-25, 2009, Paris