A Big Deal?

Corporate Social Responsibility and the Finance Sector in Europe

CORPORATE RESPONSIBILITY
the corporate responsibility coalition

The financial services sector is not regulated on a global basis and no overarching framework exists to manage key human rights issues. Codes of conduct have been established that, because of either their reach or influence, have become proxies for industry standards… such initiatives may be criticised for 'lacking teeth' if no accountability mechanisms exist to assess how well they are being implemented in day-to-day business practices. Ultimately, binding regulation may be more likely to ensure that industry leaders are not competitively disadvantaged, and that all companies operate to a set of agreed minimum standards.[1]

KPMG and F&C, September 2004

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The case studies are presented from the perspective of those organisations providing them and do not necessarily reflect the views of all the bodies involved in this publication.

Front cover
Polluting factories at Port Talbot, Wales

1. Introduction and summary

The arrival of corporate social responsibility (CSR) in Europe's finance sector is not all 'good news'. This report discusses the limitations of current voluntary initiatives to manage the negative social and environmental impacts generated by the finance sector in both developed and developing countries. It proposes an alternative agenda that is far more likely to deliver greater accountability and lasting sustainable development.

The Euro zone is now the second largest economy in the world after the US, with $8.2 trillion in gross domestic product (GDP) in 2003.[2] Europe's finance sector is part of a massive global industry which now controls a staggering $118 trillion.[3] As such, the influence the sector yields has enormous consequences for efforts to achieve sustainable development both in Europe and abroad.

Nevertheless, our political institutions have failed to challenge this influence beyond supporting piecemeal voluntary efforts to promote corporate social responsibility, all of which have failed to address effectively the key issues of climate change, poverty, human rights and sustainable development. In spite of the overwhelming evidence, the agenda for the UK's EU Presidency CSR Conference, 'Investing in the Future: a European conference on CSR and the finance sector',[4] belies the reality that the industry has so far failed to move beyond largely ineffectual attempts at self-regulation. It is our view that this agenda neglects the 'big picture' issues and the sector's responsibility as a major actor in today's globalised world. As such it represents a missed opportunity.

A Big Deal? is an attempt to redress the balance. In our ground-breaking report, we present seven case studies which clearly demonstrate the finance sector's inability to embed corporate responsibility on a voluntary basis. In particular, we reveal that the finance sector:

- provides a haven to siphon off much-needed tax revenues from cash-strapped developing countries, benefiting only a wealthy minority who avoid paying tax altogether;
- has abjectly failed to factor in the financial risks of climate change, which may ultimately lead to a global economic breakdown as the costs of climate change begin to outstrip any benefits generated by the global economy, especially for the world's most vulnerable people;
- is a primary conduit for bribery and corruption, providing billions of dollars in loans to repressive governments. European filters of finance, such as the UK's Export Credits Guarantee Department (ECGD) have failed to prevent bribery and corruption on a massive scale;
- perpetuates poverty and social exclusion in Europe, by providing unscrupulous levels of debt at high rates to those least able to afford it, all the while bringing in record-level profits;
- regularly undermines human rights protection, by financing projects which pose a threat to the implementation of human rights laws in developing countries, in breach of some companies' own codes of conduct;
- often fails to assess adequately the environmental impacts of projects and to address issues raised before releasing project finance, yet continues to reap the reputational benefits of participation in voluntary CSR initiatives.

While foreign investment is often presented as a panacea for developing countries, its potential benefits are more limited than they might appear, especially when competition among countries to attract investors leads to a lowering of standards. In the right sectors, in the right conditions, on the right terms, foreign investment can contribute positively to development. But from the high impact extractive industries to the garment sector, companies have, with few exceptions, yet to demonstrate a willingness to be concerned with its wider impacts.

As our case studies show, none of the current array of international CSR initiatives in the finance sector, ranging from the UN Global Compact's Financial Institutions Initiative to the Equator Principles, has proved capable of preventing the serious problems and abuses they purport to address. While many of the mechanisms have strong principles, their primary weakness is in the voluntary nature of such initiatives, with limited or no oversight mechanisms or sanctions for transgressions.

Voluntary initiatives have an important role in helping to define standards of best practice, but they are wholly inadequate on their own and must be coupled with binding standards of corporate behaviour. Each of our case studies provides specific issue-based recommendations to ensure that fundamental principles of accountability are adhered to. In particular, we recommend that:

- efforts to self-regulate the finance sector be strengthened with a rules-based approach which clearly defines the expectations of behaviour in this area;
- any initiatives must include an independent monitoring and enforcement regime;
- binding and credible sanctions for instances of non-compliance must also be implemented and enforced.

Moves to make financial institutions more directly accountable for their actions through such steps will go a significant way to enabling the finance sector to contribute to sustainable development targets, rather than undermine them.

Beyond individual initiatives, however, is the more important framework of Company Law that guides corporate behaviour. The current framework across Europe defines companies' primary responsibility as being to their shareholders, at the expense of society and the environment. The Corporate Responsibility Coalition (CORE),[5] supported by 130 organisations, and with affiliates in 15 EU member states, is calling for a Europe-wide approach to enact laws that guarantee corporate responsibility from the outset by requiring the following:

- **Mandatory sustainability reporting:** companies should be legally required to report against a comprehensive set of key social, environmental and economic indicators, alongside their legally required financial reports.
- **Directors' duties:** there should be a legal requirement expanding directors' duties to include a specific duty of care for both communities and the environment.
- **Access to justice:** If a company operating within the EU was responsible for a burst oil pipe, causing damage to the environment and to people's property and livelihoods, it would be held to account. Affected communities in developing countries should be similarly protected and able to seek compensation for any human rights or environmental abuses committed by European companies or their overseas subsidiaries or associates.

While the EU has recognised the challenges posed by climate change and poverty, it has failed to couple its awareness with any real action. Instead, a continued reliance on markets to achieve progress, through 'competitiveness' is continuing to halt substantial progress on both climate change targets and the laudable aims of the Millennium Development Goals.

CSR policies in the finance sector cannot be adequately addressed without an open and legitimate dialogue on regulation of the sector vis-à-vis its social and environmental impacts. Yet the EU is missing a significant opportunity to move beyond a basic 'competitiveness' agenda towards instituting policies that will more effectively balance economic priorities with social and environmental progress fit for the 21st century. This is a nettle that the UK government, in its EU Presidency role, seems unwilling to grasp.

CSR initiatives in the finance sector

The UN Environment Programme (UNEP) Finance Initiative

UNEP FI is a collaboration of more than 200 commercial and investment banks, insurance and re-insurance companies, fund managers, multilateral development banks and venture capital funds. The mission of UNEP FI is to work with financial companies and institutions to identify, define and promote good and best environmental practice in their internal and external operations, primarily through the UNEP Statement by Financial Institutions on the Environment and Sustainable Development.

One of the key problems with UNEP FI is that the statement is not binding and has no external verification mechanism, and is thus no more than an expression of good intentions. The commitments in the statement have also been criticised for not being very far-reaching or strongly worded, which casts doubt on its meaningfulness and impact.[6]

The UN Global Compact's Financial Institutions Initiative

The UN Global Compact is a CSR initiative applicable to all business sectors, expressed in 10 voluntary principles on human rights, labour rights, environment and anti-corruption. A set of recommendations and guidelines have been designed specifically for the finance sector and published in the report *Who Cares Wins: Connecting Financial Markets to a Changing World*. This includes recommendations to all sorts of financial market participants, ranging from stock exchanges, pension funds, investors, financial advisors, financial institutions and regulators.[7]

One of the problems with the UN Global Compact is that it is not a regulatory instrument, but relies on the 'enlightened self-interest of companies'. By promoting such an instrument as a substitute for international governance institutions, the UN effectively undermines the ability of national governments to put forward a different approach. Corporate involvement in the initiative has also been criticised for being little more than a public relations exercise.[8]

The Equator Principles

The Equator Principles are a set of voluntary commitments designed by a group of banks, which are similar to the environmental and social safeguard policies already being used by the International Finance Corporation (IFC), the private financing arm of the World Bank. Banks do not actually sign a statement, but 'adopt' the text and promise to implement the framework. By adopting the principles they state that they will provide loans directly only to projects that have fulfilled certain conditions. At the beginning of 2005, 28 banks had endorsed the principles.

The Equator Principles have been criticised on several levels. It is, for example, not clear whether using these principles makes a difference in practice when banks screen new projects. Banks generally decide quickly about buying into a syndicated loan project, and the extra time it takes to assess sustainability aspects might result in competing banks stepping into a lucrative project.[9] In some cases it has been questioned whether the principles have been used at all. For example, the $3.6 billion Baku-Tbilisi-Ceyhan (BTC) oil pipeline from the Caspian Sea in Azerbaijan to the Mediterranean in Turkey has been criticised for violating the principles. Eleven banks which signed up to the principles have also come under fire for urging the World Bank to reject the recommendations of the Extractive Industries Review, commissioned by the World Bank Group, thus forming themselves into a lobby group to block pro-poor reforms at the World Bank.[10]

The Collevecchio Declaration – an alternative vision for the finance sector

As an over-arching vision for responsibility in the finance sector the Collevecchio Declaration on Financial Institutions and Sustainability[11] was drawn up by a group of non-governmental organisations (NGOs) concerned with the damaging environmental and social consequences of projects financed by banks and other financial firms. The declaration was launched in January 2003. By the beginning of 2004 it was endorsed by over 100 civil society groups.

The declaration states six key guiding principles that the NGOs are calling on banks and other financial firms to adopt, and it outlines the immediate steps necessary to implement the principles. It is being used as a basis for NGOs to assess and make recommendations for other declarations, codes and CSR initiatives currently being put forward by the finance sector. NGOs working with the declaration meet regularly to update, develop and coordinate their work under the umbrella organisation 'BankTrack'.[12]

The six principles are:

1. Commitment to sustainability

A commitment to sustainability requires financial institutions (FIs) to integrate the consideration of ecological limits, social equity and economic justice into corporate strategies and core business areas (including credit, investing, underwriting and advising); to put sustainability objectives on an equal footing with shareholder maximisation and client satisfaction; and to proactively finance transactions that directly promote sustainability.

2. Commitment to 'do no harm'

FIs should commit to do no harm by preventing and minimising the environmentally and/or socially detrimental impacts of their portfolios and operations. FIs should create policies, procedures and standards to achieve that end based on the precautionary principle.

3. Commitment to responsibility

FIs should bear full responsibility for the environmental and social impacts of their transactions and pay their full and fair share of the risks they accept and create.

4. Commitment to accountability

Accountability means that stakeholders must have an influential voice in financial decisions that affect the quality of their environments and their lives – both through ensuring that stakeholder' rights are protected by law, and through practices and procedures adopted by FIs themselves.

5. Commitment to transparency

Transparency to stakeholders means having robust, regular and standardised disclosure, but also being responsive to stakeholder needs for specialised information on, for example, the policies, procedures and transactions of financial institutions. Commercial confidentiality should not be used as an excuse to deny stakeholders information.

6. Commitment to sustainable markets and governance

FIs can help foster sustainability by actively supporting public policy, regulatory and/or market mechanisms which facilitate sustainability and that help introduce the full cost accounting of social and environmental externalities.

2. Global side-effects of the banking industry

2.1 Tax evasion

While financial markets have globalised, the reach of tax authorities has remained largely national, providing big business and wealthy individuals with multiple opportunities to avoid paying tax. As a result, governments around the world are losing out on tax revenue. This is particularly damaging in poor countries, where tax revenue is essential to fund public services and the investment on which sustainable development depends. Coordinated international action to reduce the opportunities for tax avoidance and evasion is long overdue and should be considered as an essential element of the global effort to eliminate poverty.

Tax plays a crucial role in the development process as well as in creating a more equitable and stable society. Progressive forms of taxation,[13] such as income, profit or capital gains taxes, are the principal means by which wealth is redistributed. Tax is also arguably a cornerstone of democracy, giving individuals and businesses a financial stake in society. Yet taxation is facing a crisis in poorer countries.

In the developed world, government revenue from taxation between 1990 and 2000 averaged 30 per cent of GDP.[14] In sub-Saharan Africa, the average over the same period was 17.9 per cent of GDP, in Latin America 15.1 per cent and in south Asia 10.5 per cent.[15] This low tax yield in poorer regions of the world limits the level of domestically generated resources available to governments for essential public services, such as health care and education, and hampers wealth redistribution.

Capital market liberalisation has made it easier for rich people and businesses to shift their wealth and profits offshore. They have been encouraged and helped in this process by a globalised financial services industry which profits from facilitating illicit capital flight and tax evasion. The outcome, according to one recent estimate, is that $11.5 trillion of personal wealth is held offshore in tax havens, depriving governments of $255 billion of tax revenue annually. This much revenue would cover the entire financing needs of the UN Millennium Project, which aims to double aid to poor countries by 2010.

Offshore tax havens also facilitate the movement of the proceeds of corruption, criminality and illicit commercial transactions, including transfer mispricing and profits laundering to avoid tax. This creates a massive problem for poorer countries. One money laundering expert estimates the volume of ‘dirty money’ outflow from poorer countries in recent decades at $5 trillion.[16] These financial flows are facilitated by an extensive infrastructure of offshore international business corporations, offshore trusts, offshore foundations, tax havens, secret bank accounts, flee clauses, dummy wire transfers and other forms of fake financial transactions which facilitate illicit capital flight. All of which can only happen with a willing infrastructure of accountants, bankers and lawyers.

CASE STUDY 1: The great tax haemorrhage

Global accountancy firm KPMG facilitates aggressive tax avoidance

KPMG is a global business which provides accounting, auditing, tax advisory and general consulting services, including advice on corporate responsibility, to its corporate clients. Many of these clients are large multinationals operating in some of the poorest countries in the world. But for many years KPMG has also operated at the cutting edge of corporate social irresponsibility by encouraging its clients to engage in aggressive tax avoidance. This process, which frequently involves the use of tax havens, offshore tax shelters and complex lease-back deals, enables internationally active firms to exploit the differences between nationally based tax regimes.

A number of KPMG internal memos, emails and other correspondence were obtained from the company during the course of enquiries into tax shelters by the US Senate Permanent Committee on Investigations in 2003. These documents revealed that senior KPMG staff had assessed the risk of their marketing of tax shelters and decided that losing profits and competitive advantage would be more damaging than upsetting the regulators. In the words of the report of the Senate Committee, one KPMG staffer had urged his company to: 'knowingly, purposefully, and wilfully violate the federal tax shelter law.'[17]

During its enquiries the US Senate Committee discovered that KPMG had devised over 500 'active tax products', just four of which cost the US Treasury $85 billion annually in lost tax revenues, while KPMG booked $180 million in fees. Practices such as these undermine the integrity and equity of existing tax systems, increase the administrative burden of revenue collection, and shift the tax burden towards small, locally based businesses and on to workers and consumers. They are also unethical and anti-social, with damaging consequences for corporate governance and shareholder interests.

The case of KPMG is important because the same predatory practices and competitive pressures that shaped the KPMG corporate culture continue to be evident in many companies operating across the globe.

Recommendations

Below are some recommendations for bringing about a tax system that is conducive to the goals of sustainable development.

- **Achieving tax justice**

If the benefits of globalisation are to be extended to poor people, governments must regain the capacity to tax their citizens and businesses operating within their countries, and to use the revenues to finance essential public services. A fair and just taxation system is a prerequisite for poor countries to fund sustainable development through domestic resources, rather than relying on aid and external debt. Tax justice would be enhanced by the following recommendations:

- **Strengthening international cooperation on tax**

Enhanced cooperation on tax matters, for example through an international regime of automatic information exchange agreements which extended to tax havens, would significantly reduce the opportunities for tax evasion. Additionally, the introduction of what is known in taxation law as a 'general anti-avoidance principle' would help to clarify legal grey areas surrounding the mispricing of imports and exports within companies.

- **A just tax system for multinationals**

To prevent multinationals avoiding taxation, a special set of rules could be introduced for taxing their profits internationally and at an agreed rate, and distributing this across the countries in which the company operates. A global minimum rate of corporate taxation should also be considered.

- **An institutional home for tax justice**

The creation of a World Tax Authority could assist with monitoring the impact of national tax policies and could protect national tax regimes from harmful and predatory practices. Such an authority could be responsible for tackling tax competition, tax havens and profit laundering – thereby levelling the global playing field.

Source: Tax Justice Network and Christian Aid

2.2 Climate change

The UN Environment Programme's Finance Initiative estimates that on current trends, worldwide economic losses due to natural disasters – the vast majority being hydro-meteorological and therefore directly affected by climate change – will hit $150 billion a year in the next decade: roughly three times the size of the global aid budget. Although no precise estimate of all future costs can be made, a European Commission paper puts the future cost of all the potential cumulative global damage at €74 trillion at today's value, just for Europe, if effective action is not taken.[18]

As a former director of one of the world's largest insurance companies, Aviva, Andrew Dlugolecki did his own sums and came to another more dramatic conclusion. Comparing annual average economic growth figures with a linear projection of rising climate, and more specifically, carbon-related damages, he concluded that by about 2065 damages would exceed gross world income. In other words, climate change will have bankrupted the global economy.

The important thing, then, is action. Action to stop climate change, but not to ignore that for many people living in resource-poor countries 'dangerous' climate change is already with us. And, at the moment, these people are being cast adrift and left to sink by rich countries in a warming world.

In 2001, at the seventh Conference of the Parties to the Climate Convention (COP7) in Marrakech, rich countries committed themselves to provide $0.41 billion a year by 2005 to help developing countries 'manage their emissions and adapt to climate change'.[19] Since then, however, only about $0.03 billion has been found. Even when the UK hosted the G8 Summit in 2005, and put climate change and international poverty reduction at the top of the summit's agenda, it had failed by that time to contribute to either key fund to help the poorest countries adapt.

But even the larger figure looks modest compared to the annual subsidy given by rich countries to their own, heavily polluting, fossil fuel industries, conservatively estimated at around $73 billion per year for the late 1990s.[20] And, compared to the scale of the problem, even the committed funds look hopelessly inadequate. As the official US Global Change Research Information Office points out:

> It is estimated that with 1 metre sea-level rise, protection of the vulnerable portion of the coastline of Dar es Salaam would cost US$380 million and protecting the populated coastline of Tanzania would cost US$14.6 billion.[21]

Wealthy members of the international community, overwhelmingly responsible for current global warming, are obliged by international legal norms and moral codes to meet much of the cost of the problem in poor countries. The Intergovernmental Panel on Climate Change (IPCC) comments that 'there are few comprehensive estimates of the costs of adaptation.'

However, the cost of global warming to wealthy countries dwarfs the sums on offer from rich to poor countries. In just one case the cost of maintaining the functions of Japanese infrastructure alone against a one metre rise in sea level is estimated to be between around £65 billion and £100 billion.[22] Ironically, estimates show that in the US, energy demand would increase significantly to help adapt to climate change, while also accelerating warming due to increased emissions. The cost of meeting the higher demand might be between $200 billion and $300 billion, with annual costs rising by $33-73 billion.[23]

CASE STUDY 2: Investors, insurers and climate change

Investors and climate change

Although the poorest people living in the poorest countries, who had least to do with creating the spectre of global warming, are set to be hit first and worst by climate change, it is clear that nobody can escape the effects. An analysis of the FTSE 100 share index by city firm Henderson Global Investors calculated that the climate-related risk faced by some companies was bigger than their entire earnings.[24]

Extreme weather conditions synonymous with climate change are already translating into real economic losses:

- Severe floods across Europe in 2002 caused direct economic losses of $16 billion.
- The 2003 heat-wave that affected much of Europe is estimated to have caused 26,000 premature deaths and had an estimated economic cost of $13.5 billion.
- Claims for storm and flood damages in the UK doubled over the period 1998-2003, compared with the previous five year period, according to the Association of British Insurers.[25]

Assets held by institutional investors, such as listed equities, fixed income, property and private capital are also under threat. For example, there are:

- regulatory risks in terms of compliance with emerging carbon policies across the world, such as the EU Emissions Trading Scheme (ETS);
- physical risks from the direct impacts of climate change. Agriculture, property, tourism, water and insurance sectors are particularly exposed;
- operational risks, as carbon constraints impinge on existing assets, costs and capital expenditure (for example, as energy and carbon prices rise);
- market risks in terms of changing dynamics for a company's goods and services (for example, through a shift to more energy-efficient products);
- legal risks through the potential for increased litigation against companies contributing to climate change; and
- reputational risks as corporate responses to climate change alter brand values and perceptions among customers, staff, suppliers and shareholders.[26]

The Carbon Trust recently concluded that climate change could become a mainstream consumer issue by 2010, putting brand value at risk in a range of sectors.

Some immediate developments are hastening the market's response. Catalysts include both official and voluntary initiatives such as the EU's ETS and the Carbon Disclosure Project (CDP). The EU scheme was introduced to help Europe meet its international obligations under the Kyoto Protocol. The Protocol, agreed in 1997, set an overall reduction target of 5.2 per cent for industrial nations between 2008 and 2012, compared with 1990 levels. Despite the decision of leading countries such as Australia and the USA not to ratify the Protocol, it became legally binding on 16 February 2005.[27]

The EU's ETS came into effect in January 2005 and covers around 44 per cent of the EU's greenhouse gas emissions. It sets a cap on emissions and allocates tradeable permits to about 12,000 installations in key industrial sectors: energy generation, ferrous metals, minerals, paper and pulp. The essence of the scheme is that operators must either purchase permits or pay a fine if they exceed their allocation. On the other hand, they can sell part of their allocation if they are below their limit. The scheme is currently valued at around €35 billion per year, and is expected to rise to over €50 billion by the end of the decade.[28]

According to Henderson Global Investors, so far, the full financial implications of the scheme have been, 'muffled by allocating allowances free to operators and back-loading the required reductions to the second part of the 2005-2012 period'. Indicating possible future trajectories they point out that, by May 2005, prices had already risen to over €19 per allocation from €7 in April 2004. In addition, the second phase (2008-2012) will be characterised by increased carbon constraints, and accelerating the pace of carbon reduction needed for the EU to meet its Kyoto target.

The Carbon Disclosure Project was launched in the UK in December 2000, but has recently been expanded to also include international investors. Setting out to speed up the transition to a carbon-constrained global economy, at the global level, the CDP has mobilised 143 institutional investors with over $20 trillion under management to improve disclosure from the world's leading 500 companies.[29]

Examples like these show how amounts of money which are relatively small compared to the whole capital markets, where around $1.5 trillion is traded every day, can nevertheless catalyse wider awareness and change.

Insurers and climate change[30]

More than many other sectors, the insurance industry is at the cutting edge of economic adaptation to climate change. Global firms like Swiss Re and Munich Re provide much of the original data on the economic costs of extreme weather events. From the household level to global agricultural production it is through insurance that the true costs of adaptation and major economic fissures are most likely to be revealed.

Insurance estimates and rising dividend payments may also provide the missing link in bringing legal claims for compensation into the heart of the global warming issue. There are wildly varying estimates of the costs of Hurricane Katrina in the US. The bill to the insurance industry has been quoted at between $25 and $50 billion making it potentially the world's most expensive weather-related disaster.[31] The only thing holding back climate change inspired court claims has been the problem of attribution.

But looking at how the insurance market works, Myles Allen from the physics department at Oxford University suggests that problem is now largely solved. 'All you have to do', he writes in science journal Nature, 'is work out a "mean likelihood-weighted liability" by averaging over all possibilities consistent with currently available information.' Unpacked, that means that if past greenhouse gas emissions increase flood risk tenfold, and a flood happens, 90 per cent of subsequent damages can be attributed to past emissions. Because carbon dioxide mixes itself in the global commons of the atmosphere, 'an equitable settlement would apportion liability according to emissions'.[32]

As the Association of British Insurers (ABI) points out:

> Climate change is not a remote issue for future generations to deal with. It is, in various forms, here already, impacting on insurers' businesses now.

The sector's response gives a window on private sector adaptation. It reports the main ways in which climate change currently affects the insurance business:

- changing customer needs, requiring new underwriting skills as customers seek to limit new liabilities arising from climate change regulation, or exploit new assets;
- changing patterns of claims, principally on the household, property and business interruption accounts;
- new and tightening regulation, driving business costs and, increasingly, impacting on the investment environment;
- a source of reputational risk, requiring the industry to communicate effectively with customers, government and other stakeholders, so that they understand the financial consequences of climate change, the options for managing these and the response of the industry to these challenges.[33]

The 'risk transfer mechanisms' of insurance are likely to be applied in various ways to deal with the increasing exposure to extreme weather; to insure new technologies, such as renewable energy assets; and to manage new liabilities, such as directors being held responsible for the environmental impact of their businesses in the future.

For Britain alone, the ABI reports that weather risks are increasing by 2-4 per cent a year for households and other property owing to changing weather. Claims for storm and flood damages doubled to over £6 billion between 1998 and 2003, compared to the previous five years. Other insurance areas that saw rising claims from climate-related effects, including rising motor insurance claims, and human health effects that could 'influence the balance between state and private provision of health care and pension products'. Overall, for the industry, with damages hitting $150 billion a year in 10 years, insurers stand to be hit with at least $30-40 billion in claims annually.[34]

Insurance premiums are the reverse side of the coin of climate-related damage costs. They are deliberately long-term, so they are likely to represent a significant adaptation cost. As we are locked into an inescapable degree of climate change over the next 30-40 years owing to past emissions of greenhouse gases, the insurance cost for particularly vulnerable infrastructure and sectors will continue to rise.

Recommendations

Investors currently have to 'fly blind' about the risks companies are exposed to from global warming and the new regulatory environment emerging to deal with it. Numerous market distortions also exist that block the shift to a climate-friendly global market. But action could be taken to change that.

• Carbon disclosure
Companies should be obliged to disclose their 'carbon risks', both when they list on stock exchanges and in their annual reports. Carbon disclosure is essential to enable investors to make informed choices about how climate change risks will affect their portfolios. Carbon disclosure needs to be quantitative, comprehensive, comparable, timely and targeted.

• Carbon governance
Climate change should be an intrinsic part of corporate governance. Corporations should internalise the costs of greenhouse gas emissions into all decision-making. They should set targets and timetables to reduce their greenhouse gas emissions compatible with an international framework to halt dangerous climate change that delivers fairly shared emission entitlements at a global level. Considerations of global warming can be incorporated at all levels, including in the companies' articles of association, corporate strategy, policy reviews and market analysis.

• Climate proof investment
Investment needs to be directed to where it can make the most positive impact, such as renewable energy options, and barriers that hamper this kind of investment should be removed. In line with the findings of the World Bank's Extractive Industries Review, the proportion of investment into renewable energy within the World Bank's wider energy portfolio, which acts as a benchmark for private investors, should increase by a rate of 20 per cent a year, until all World Bank support for oil projects is phased out by 2008.

• Increase funding for renewable energies
In line with the recommendations of the G8 renewable energy task force the reform of international financial institutions (IFIs) and export credit agencies is needed to dramatically increase funding for renewable energies in developing countries. This can include phasing out G8 government subsidies for fossil fuels and nuclear energy, while increasing research and development for renewable energy.

Source: nef (the new economics foundation)

3. Banking on corruption

3.1 Bribery and corruption

Corruption is a major obstacle to the development of many of the world's poorer countries. Ongoing research by the World Bank suggests that over $1 trillion is lost annually to bribe-paying, excluding embezzlement of public funds or theft of public assets – a significant figure in the context of global economic output of $30 trillion.

In Africa the situation is much more serious. In 2002 the African Union estimated that around $150 billion – or one quarter of the continent's GDP – is lost to corruption annually, lifting the cost of goods by as much as 20 per cent, further deterring investment in those countries.[35] The situation appears to be getting worse rather than better.

Much of the corruption problem lies in the resource sector – an industry that relies on government concessions. For instance, roughly 36 per cent of the US Justice Department and Securities Exchange Commission cases brought under the Foreign Corrupt Practices Act since 1977 have involved natural resource extraction. Further, impoverished countries' resource assets represent one of the few ways through which they can pull themselves up the development ladder.

Corruption has three main dimensions. First, an environment is created in which money is made available and can be stolen, for instance via loans from western banks or multinational companies' investment into an opaque fiscal regime dominated by strong politicians concerned with protecting their lucrative positions. Second, local officials misappropriate those assets, potentially with the collusion of international actors. Finally, stolen funds are laundered back into the financial system, usually finding their way back into accounts in developed, safe countries.

Money laundering initiatives undertaken in recent years have begun to address the final part of this process and have been reasonably effective in tackling the matter, although significant work lies ahead on issues such as repatriation of retrieved assets.

The second stage occurs largely in host countries, which are frequently institutionally weak and lack effective systems to stamp out corruption. As in the Bonny Island case in Nigeria described below, multinational firms supported by western governmental or private institutions are often complicit in bribery, and yet western governments and financial institutions have done little to exert pressure on companies operating in those countries. Government export credit agencies, for instance, provide critical risk management assistance to companies seeking to invest in developing countries, but fail to use this position to bring the actions of those private sector clients into line with their governments' broader anti-corruption policy aims.

Western institutions also have a significant role to play in the first step. Multilateral agencies such as the International Monetary Fund (IMF) and World Bank have attempted to promote transparency and accountability as part of their programmatic work in corrupt developing countries. However, their effectiveness is undermined by the fact that private sector banks offer a 'no strings attached' option to governments that helps to sustain their opacity and corruption. In recent decades, as the importance of private sector flows into developing countries has grown in importance relative to official aid and multilateral lending, policing the activities of private sector banks has become increasingly important.

Europe is the worldwide centre for lending activities. London alone is the origin of 20 per cent of all cross-border lending, followed by Germany.[36] Europe must use this position of strength to align the activities of the banking sector with its own broader policy aims. The massive scale of the problem – multiples of the value of debt for which the G8 has promised relief to African countries – and the central role the financial sector plays in sustaining it should put the issue firmly on the agenda of any CSR discussion.

CASE STUDY 3: Bribery at Bonny Island: the failure of weakened anti-bribery procedures

Three countries investigate case that reveals failures of weakened ECGD anti-bribery measures

Corruption is a major obstacle to poverty reduction and sustainable development in Nigeria. Export credit agencies, which help finance large investment projects in countries like Nigeria, could use their unique position to encourage better governance and help ensure that foreign investment brings tangible benefits to the citizens of poor countries. Yet without effective anti-corruption procedures, export credit agencies have limited influence to prevent bribery and other corrupt practices.

Investigators in France, Nigeria and the US are currently examining allegations that between 1995 and 2003 a major energy consortium, TSKJ, paid over $170 million in bribes to win billions of dollars worth of work on a liquefied natural gas (LNG) plant at Bonny Island in Nigeria.[37] TSKJ is a joint venture of companies comprising Technip of France, Italy's Snamprogetti, JGC of Japan, and Kellogg Brown and Root (KBR), a subsidiary of US company Halliburton. The allegations are that TSKJ paid $175 million to an agent through one of its offshore companies, and that the agent used this money to pay bribes to Nigerian officials and expatriate managers of KBR. Investigators in Switzerland are also examining whether payments made to the former Nigerian dictator, Sani Abacha, are linked to the project.[38]

The UK's Export Credits Guarantee Department (ECGD) was one of a number of export credit agencies that helped to finance the project in December 2002. The ECGD gave support worth £127 million on the project to MW Kellogg, a UK subsidiary of Halliburton, for goods and services including project management. Despite the investigations taking place in other countries, the UK authorities have so far failed to open one of their own.

No-bribery declarations in contracts have very limited impact

The agent involved in the TSKJ project was a London-based lawyer acting through his Gibraltar based company Tri-Star. He signed an agreement with one of the TSKJ offshore companies in 2001 for 'consulting and commercial promotion services for the Nigeria LNG Plus Project'. According to this agreement, the agent was to receive a fee of $51 million to be paid into a bank in Monaco for his services.

In 2004, Halliburton revealed that an internal probe had uncovered notes written between 1993 and 1998 showing that consortium executives discussed bribes to Nigerian officials in order to win the contract.[39] Halliburton has also reported in its filings to the US Securities and Exchange Commission that it understands from the ongoing investigations that payments were actually made to Nigerian officials. The former Nigerian chairman of Nigeria LNG Ltd has admitted to a Nigerian House Committee that he received 'loans' from the agent some of which he did not pay back, although he denies that these were bribes.[40]

The agreement with the agent included a no-bribery declaration. The fact that it did so shows the limitations of requiring agents and other parties to make such declarations. While they may look good on paper, such declarations are not sufficient to stop bribery.

ECGD anti-corruption procedures fall short

In March 2003, shortly after it gave support to MW Kellogg, the ECGD gave a presentation to its advisory council, EGAC on the Bonny Island project. Council members asked about the possibility of corruption on the project. The ECGD told them that 'this had been dealt with in the underwriting process in the normal way'.[41] This case reveals the weaknesses of ECGD's anti-corruption procedures. For example, large offshore payments to a UK-based agent for vague services should have raised a multitude of red flags, particularly when that agent was not based in Nigeria.

The bribery allegations at Bonny Island, Nigeria, raise several other questions about weaknesses in the ECGD's anti-corruption procedures and about how they are being applied in practice. First, the ECGD's sanctions for bribery are inadequate and entirely discretionary.

Under current procedures, if a company is convicted of bribery on a project underwritten by the ECGD, it will have its cover voided and will have to repay any sums in cases where there has been a loss or default. Companies therefore face a financial penalty only if there is a loss or default. Corruption does not, however, always result in a loss or default.

The other main sanction that the ECGD has at its disposal is refusing further cover to a company that is convicted of bribery or freely admits to bribery. Yet when the ECGD received an application from a subsidiary of Halliburton it failed to take account of considerable evidence that the group had engaged in bribery. The treatment of Halliburton raises serious questions about the ECGD's procedures for assessing whether a company should be refused cover, and how the ECGD deals with allegations once they emerge. Minutes of meetings between the ECGD and Halliburton show that the ECGD failed to push Halliburton on crucial details of the allegations and told Halliburton that it did not wish to 'delve into the finer details' of the consortium's agency arrangements.[42]

Recommendations

Anti-bribery procedures should be strengthened
If the ECGD is to avoid being complicit in the bribery of corrupt governments by large companies the following recommendations should be considered:

- The ECGD's sanctions process should apply regardless of whether there is a default or not; a fixed and mandatory penalty would be one way of addressing this inconsistency.
- The ECGD should seriously consider adopting a proper blacklisting system, debarring companies found guilty of corruption or admitting to corruption for a period of three years.
- The ECGD should also consider putting in place a proper regime of suspending companies that face investigations for bribery on ECGD-backed projects pending the final outcome of an investigation. This would greatly assist investigative authorities in gaining greater cooperation from companies.
- The ECGD must be more pro-active and robust in pushing companies facing allegations of bribery to provide detailed information and explanations, and refuse further cover to them where they fail to do so.

Source: The Corner House

CASE STUDY 4: Cash, corruption and commodities

The external debt of low-income developing countries stood at $523 billion in 2002. Of that amount over three-quarters was either lent to, or guaranteed by, public bodies in those countries. Lending by private banks constitutes a considerable part of this total. While IFIs have established certain guidelines for their concessional loans, designed to ensure that they serve development and poverty reduction goals, the same procedures do not govern private sector lending.

The dangers of collateralised borrowing

Governments in resource-rich poor countries, many of which have high levels of corruption and bad governance, frequently seek loans using future exports of natural resources, such as oil, as collateral. By taking out such ‘resource-backed loans’, unaccountable governments mortgage their country’s future income in return for cash today, while burdening the country with debt. Governments are not required by the lending banks to disclose the proposed uses of the funds, to track actual uses, or even to report whether and on what terms the loans have been made. This inherent lack of transparency undermines sustainable development in poor countries, creating a borrowing environment in which corruption and mismanagement of public funds can flourish.

The IMF has expressed concern regarding collateralised lending, including the opportunities it creates for corruption, the fiscal constraints that can result, the effect on countries’ ability to access international capital markets and the high costs of borrowing associated with the loans.[43] Several governments have been required to make commitments to cease such borrowing under IMF assistance programs.

Western banks help Angola mortgage future oil income

In 2004, Standard Chartered was lauded in the financial press for its role as the lead arranger for a $2.35 billion oil-backed loan to Sonangol, the Angolan state oil company. Barclays, Banco Espirito Santo, Calyon, Commerzbank, Deutsche Bank, KBC, Natexis Banques Populaires and Royal Bank of Scotland were also involved in the loan.

According to the 2004 State Department Report on Angola, ‘[c]orruption, nontransparent contracting practices, and unfair enforcement of regulatory and tax regimes favored the wealthy and politically influential. Poor governance continued to limit the provision of basic services to most citizens.’[44] In its Corruption Perceptions Index for 2005, Transparency International ranked Angola among the worst offenders, 151 out of 159 countries surveyed.[45]

Oil is the main source of income of the Angolan government and with prices at record highs, total oil revenues for 2005 are estimated at around $6.88 billion. Yet despite its vast oil and diamond wealth, Angola remains one of the world’s poorest countries, ranked at 160 out of 177 on the UN’s Human Development Index. Most Angolan citizens live on less than $2 a day and at least 45 per cent of Angolan children are severely malnourished. Social expenditure has, according to the Economist Intelligence Unit, ‘historically […] been shockingly low even by regional standards’.[46]

Bank lending perpetuates indebtedness, corruption and poverty

At the heart of Angola’s poor development record lies its huge indebtedness which currently stands at $9.5 billion, equivalent to 50 per cent of the country’s GDP. The World Bank has described the government's oil-backed lending as the core obstacle to the country’s development. The international donor community and development banks have continued to insist on concrete improvements in good governance, including progress towards more responsible and transparent management of the country’s natural resource revenues, before providing Angola with concessional loans and debt relief.

However, the willingness of western banks to lend to Angola has undermined international pressure for reform. The government continues to seek expensive commercial loans backed by oil rather than seeking cheaper loans from development banks, which would require a commitment to more transparency. In September 2005, a syndicate of banks, led by the French bank Calyon, was planning to lend another $2.25 billion to Sonangol. The deal appeared to be in part a refinancing of existing debt, but will include at least $800 million of new money for undisclosed use.[47]

The Angolan case is symptomatic of many resource-rich poor African countries. With many states already heavily indebted, lenders have turned to more complex methods to extend credit to those countries, such as using increasingly sophisticated financial instruments to exchange future mineral exports for money today.

Recommendation

Transparency and disclosure should be enhanced

As their importance in providing finance to developing countries has grown, private sector banks must now take broader anti-corruption and good governance issues into account when making funds available to governments. It is crucial that the negative development impacts of oil-backed lending be addressed. International and national banking regulators have introduced enhanced transparency and due diligence such as 'Know Your Customer' rules to combat the laundering of terrorist finance and the proceeds of corruption.

Similarly, banks should support enhanced transparency in oil-backed lending if they are to avoid complicity in the mismanagement and misappropriation of a country's resources by corrupt and unaccountable governments. This enhanced transparency would include disclosure of loan terms, the end use of the funds disbursed and the identity of the recipient or beneficial owner of the recipient account.

Source: Global Witness

Angola's children live in poverty despite the country's mineral wealth
© Global Witness

4. Banking on poverty and social exclusion

4.1 Tackling exclusion and expanding access

Global banking franchises control worldwide assets that dwarf the economic output of many developing countries. According to the British Bankers' Association (BBA), the Royal Bank of Scotland alone accounted for £600 billion in global assets in 2004,[48] which is seven times the total flow of foreign direct investment to developing countries measured by the World Bank in the same period.[49] With this level of economic power, banks have increasing control and influence on social, economic and environmental impacts in the countries in which they operate. But compared to the high profile of banks in relation to international development, less examined is the extent to which banks adhere to principles of social responsibility in the countries where they are based – the developed economies in the Organisation for Economic Cooperation and Development (OECD).

As an example of the performance of the financial service industry in Europe, the UK banking sector has been the subject of considerable critical analysis. The UK banking sector is dominated by five large banks, which together control 84 per cent of current account provision for UK consumers.[50] In aggregate, the four largest banks earned profits in excess of £23 billion in 2004, of which approximately £7 billion was from their UK retail operations.[51] This implies that banks make a profit of about £126 per customer per year. With consistent average return on equity of 20 per cent, the UK retail banks stand out as an extremely profitable industry.

The BBA's CSR guidelines provide a framework for the sector to address and report on its positive corporate practices.[52] A commitment to CSR is evident in the philanthropic and community investment activities of UK banks. Significant resources have been devoted to giving, volunteering, and partnering with local communities.

However, UK banks' public commitment to CSR has not extended to consideration of the direct economic and social impacts of their business models on the individuals they serve. A lack of social responsibility is evident in UK banks' policies relating to unsecured lending, financial exclusion, fairness and transparency. While UK banks highlight the positive impact of their investment and support for disadvantaged communities, in many cases they are undermining this very work with products and services that negatively affect their customer base.

Poor service provision

Oligopoly and voluntary regulation have limited greater fairness and transparency in the sector. As a recent Economist survey of international banking noted, 'British banks are world leaders at confusing their customers and extracting extra charges.'[53] With significant market shares and a relatively captive consumer base, banks have had little imperative to review their customer service, pricing and fee-charging structures. The poor performance of banks in provision of current account services was first raised by the 2000 Cruickshank report, which specifically noted the lack of competition in the sector.[54] A *Which?* 2004 survey of approximately 5,000 members indicated that bigger banks with larger market share ranked the lowest in customer satisfaction.[55]

Basic bank accounts

Banking services are fundamental to daily life, providing identification, essential transactions, access to basic services, and economic inclusion in a market society. Yet financial exclusion in the UK is an often overlooked issue. Over 13 per cent of individuals in the UK are without access to a current account.[56] When reviewed against deprivation indices, the percentage of individuals without accounts increases dramatically to 35 per cent of individuals living in deprived areas. For this reason, the UK government pressed banks to introduce basic bank accounts. These are simple transactional accounts open to all, regardless of credit history or income level. Introduction of basic accounts was agreed with UK retail banks as part of their social responsibility and voluntary commitment to the UK Banking Code.

The banking industry signed up to work with the government to halve the number of unbanked households in the UK by 2006. However, UK banks' commitment to basic bank accounts is limited by a number of barriers. A report by the National Consumer Council, *Basic Banking: Getting the First Step Right*,[57] notes ongoing criticism of the banks, both in their failure to promote basic bank accounts, and at times, outright discouragement of applicants.

CASE STUDY 5: Counter service: how banks fail their customers

UK banks fail to serve customers' best interests

UK banks have become the epitome of poor service, lack of transparency and unresponsiveness to consumer interest. While banks have publicly committed to principles of corporate responsibility to achieve enhanced social and environmental goals, they have lost sight of the impact their business practices have on the customers they serve. Given the weak competition in the UK banking sector, the market leaders have had no incentive to respond to customer demand. Banks are driven by a profit imperative to satisfy shareholders, a fact which often conflicts with consumers' best interest.

Poor service provision

Banks have come under pressure for exploiting customers through a culture of excessive fees and charges. This is evident in banks' policy relating to unauthorised overdrafts, account charges, and delayed cheque clearance. The practice of charging on unauthorised overdrafts nets the industry approximately £3 billion a year.[58] Most banks charge a monthly fee of between £20 and £30 for customers exceeding the overdraft limit, with an additional 'unpaid fee' of around £35 for every transaction with insufficient funds.[59] Many banks impose punishing interest rates on overdrafts of close to 30 per cent. This is a profitable endeavour that the banks are extending further by raising the rates on such charges.[60] In many cases, an overdrawn account may be due to the fact that it takes longer to clear payments in the UK than in any other of the G10 nations. The UK banking industry has provisionally agreed to implement fast clearing times by 2007, but only Lloyds TSB and HSBC currently refund customers the interest lost during the transfer period.

Customers are also being sold inappropriate products such as loan cover in the form of payment protection insurance (PPI). About 25 per cent of credit card customers and half of loan customers buy payment protection from their bank.[61] Banks have been accused of putting pressure on borrowers to take out PPI policies because the margins earned on these products are so high. A *Which?* report found that insurance products were often mis-sold and a large number of claims were turned down, resulting in large profits for the banks.[62] An investigation by the Financial Services Authority (FSA) concluded that advice on PPI was likely to be poor; the level and structure of incentives and targets for sales staff could encourage mis-selling; and training and competence of sales staff was not adequate.[63]

An April 2005 report into high street banks by leading investment bank Credit Suisse First Boston concluded that banks take in around £2 billion a year in payment protection premiums, making between £1 billion and £1.5 billion profit on this. Among the larger banks, it estimated that in 2004 Lloyds TSB earned nearly 14 per cent of its total profit from premiums on loan insurance, while Barclays made around 11 per cent. In 2004, the Guardian published details of how Barclays was enjoying profit margins of 70 per cent selling payment protection policies to more than 2 million customers. Barclays takes around £350 million a year in PPI premiums, yet pays only some £90 million in claims. As few as 5 per cent of PPI policies end up with a claim.[64]

A *Which?* report also found that protection on personal loans is expensive, gives limited cover, and can be useless for the self-employed or those on contracts. Britain's banks now face a government enquiry into the sale of payment protection insurance policies after Citizens Advice issued a super-complaint against what it calls a £5 billion 'protection racket'.[65]

Irresponsible lending

Consumer groups claim that UK banks encourage people to take out credit they cannot afford in order to increase profits. Staff are pressured to meet targets for selling loan products, with incentives that discourage determination of an individual's ability to repay. These accusations were made in response to the March 2005 release of figures indicating that banks wrote off a record £6 billion of bad debts in 2004 – double the figure of five years ago. Credit card debts alone account for £2 billion, a twentyfold increase in 10 years. The damaging effects of personal and credit card debt are confirmed by the most recent figures from the Department of Trade and Industry (DTI), indicating that personal insolvency in the third quarter of 2005 increased by 46 per cent over the same period last year.[66]

Many UK banks have become involved in sub-prime lending (lending to borrowers who would not normally qualify for a loan), either directly or as shareholders. HSBC acquired US based sub-prime lender Household International in March 2003. Household made a record $484 million (£270 million) settlement in a class action lawsuit regarding claims about predatory lending in November 2002.[67] Following the acquisition, HSBC appointed Household International CEO William Aldinger to its Board of Directors with a pay package of £37 million over three years.[68 69] HSBC also makes sub-prime loans in the UK under the name of HFC Bank and Beneficial.

HSBC is currently expanding the Household International consumer financial model to Brazil, India and elsewhere. On the back of such strategic decisions, HSBC has continued to generate record profits, earning an unprecedented £9 billion in 2004 – roughly equivalent to £1 million an hour. With five top executives receiving £36 million in pay, the bank was under pressure from consumer groups such as the Independent Banking Advisory Service (IBAS) to demonstrate that these record gains are not at the expense of UK consumers.

These concerns are not exclusive to HSBC. Nationwide Building Society issued a report calculating that UK financial institutions as a whole made an astonishing £15.8 billion in profits in 2004 while at the same time Britain's debt soared to more than £1 trillion. Calling for 'good value, fairness and honesty', Nationwide Building Society boss Stuart Bernau said: 'Banks are making record profits but some providers continue to offer poor value. People are dissatisfied. The industry must rebuild trust.'[70]

Recommendations

How UK banks could better serve consumer need

To provide fair and appropriate products and services that meet consumer need, recommendations for the UK banking sector include:

- Ban unsolicited credit offers.
- Strengthen the Consumer Credit Bill by defining 'irresponsible lending' and including a flexible ceiling on interest rates and charges to help protect vulnerable individuals from over-indebtedness and irresponsible lending practices.
- Create an effective benchmark of bank performance on basic bank accounts and financial exclusion initiatives.
- *Which?* consumer standards governing the UK retail banking sector could provide a mechanism to align shareholder and consumer interests.
- Make banks subject to a universal service obligation which would mandate the affordable provision of basic accounts to all individuals, making this inherent in the receipt and continued operation of a banking licence.

Source: nef (the new economics foundation)

5. Banking on human rights abuses and environmental degradation

5.1 Enhancing scrutiny and transparency

Oil, mining and retail companies may bear the brunt of campaigns against human rights and environmental abuses because of their operations and supply chains in developing countries. But the banking sector is increasingly coming under scrutiny for its role in financing projects that may involve human rights abuses and negative impacts on the environment and local livelihoods.

In 2002, an Expert Panel set up by the UN Security Council condemned 85 multinationals – including five financial services institutions – for aiding in the plunder of the Democratic Republic of Congo's wealth. In 2003, several financial services institutions experienced public protests for allegedly financing rainforest destruction and displacing local populations, through the provision of debt or equity finance, or advisory services, to Indonesia's Asia Pulp and Paper Company Ltd. Also in 2003, more than 30 of the world's leading international banks and corporations faced a claim in the US, under the Alien Tort Claims Act (ATCA), for $100 billion in damages for their role in supporting apartheid in South Africa. Barclays, NatWest and Standard Chartered were among those named in the law suit.

In 2004, environmental groups called on banks including Goldman Sachs, Merrill Lynch and HSBC not to sell bonds worth more than $2 billion on behalf of the China Development Bank and the China Export Import Bank. They argued the bonds would be used to finance controversial infrastructure projects, including the Three Gorges Dam.

Financial groups are also being scrutinised over working conditions in their own supply chains, especially where jobs are outsourced at home or abroad. HSBC came under fire in 2004 from trade unions over a delay to a promised wage increase for low-paid contract cleaners at its headquarters at London's Canary Wharf.

According to a 2004 study by KPMG and F&C Asset Management, 'there is little evidence that human rights are being systematically integrated into sovereign or project credit risk assessments'.[71]

Road through destroyed rainforest
© Aulia Erlangga / Friends of the Earth

CASE STUDY 6: Putting a price tag on human rights: private investment agreements

Private investment agreements threaten human rights

In some countries, the exploitation of natural resources has contributed to a deteriorating cycle of corruption, social unrest, conflict and abuses. Amnesty International has found that the legal framework of agreements that underpin investment projects poses a serious threat to human rights, especially in countries and contexts where human rights violations are prevalent.

The Baku-Tbilisi-Ceyhan pipeline project

In 2003, Amnesty International published a report on the human rights implications of the Baku-Tbilisi-Ceyhan (BTC) pipeline project.[72] At this time, a consortium of oil companies led by BP was planning to build an oil and gas pipeline from the Caspian Sea, through Azerbaijan, Georgia and Turkey to the Mediterranean. A project of this size was bound to have wide ranging consequences for people living in the region, and Amnesty International was concerned about the human rights implications, particularly in the light of the poor human rights record of the countries concerned.

The report showed that the legal agreements underpinning the project systematically undermined mechanisms for protecting human rights. The project was established under a framework of special agreements between the three states, and between each state and the consortium. These agreements imposed conditions on the governments of Azerbaijan, Georgia and Turkey that constrained them from giving effect to human rights law and standards.

In particular, the agreements contained ‘stabilisation’ clauses, under which the three host governments agreed to compensate the oil companies if new environmental or social legislation was introduced that affected the ‘economic equilibrium’ (read profitability) of the pipeline. Amnesty International argued that such stabilisation clauses would have a ‘chilling effect’ on the willingness of the host governments to embrace higher human rights standards – creating a huge disincentive on them to fulfil their international human rights obligations.

The BTC consortium responded to some of the concerns expressed in Amnesty International’s report by drawing up a ‘Human Rights Undertaking’. The ‘Human Rights Undertaking’ is a legally binding agreement, which guides the consortium’s interpretation of the State-Investor Agreements (SIAs) underpinning the BTC project in an effort to ensure they cannot be used to undermine human rights protection in Turkey, Georgia or Azerbaijan. The undertaking is, however, binding only on the companies and does not form part of the package of legal agreements that govern the project. Moreover, BP is on record as saying that it will not be bound by the undertaking if new laws introduced by the three host governments are deemed by the company to constitute ‘rent seeking’.

The World Bank’s private sector lending arm, the International Finance Corporation (IFC), privately acknowledged the arguments set out in the report and undertook to examine their implications. The European Bank for Reconstruction and Development has also reviewed the BTC agreements with reference to these arguments.

The Chad-Cameroon pipeline project

Amnesty International is now concerned that a pipeline transporting oil through Chad and Cameroon is bringing with it potential threats to human rights in the two Central African countries. In one of the largest private sector investment projects in Africa, a consortium of oil companies is extracting oil from the Doba oilfields in southern Chad and transporting it 1,070 kilometres by pipeline to Cameroon’s Atlantic coast. The consortium is led by the US company, ExxonMobil, and other members include Chevron, another US corporation, and Petronas, the Malaysian state oil company.

The profile of the project has been raised because of substantial backing from the World Bank Group, in the form of a $200 million loan from the IFC. The project has also been supported by export credit agencies and private banks including ABN AMRO and Crédit Agricole – some of which have voluntarily adopted social and environmental standards.

Yet the agreements that underpin the project could prevent the governments of Chad and Cameroon developing effective human rights protection for their citizens and make it more difficult to hold the companies involved in the project accountable for abuses of human rights that result from their activities. In a recent report, Amnesty International showed that the project agreements may encourage the governments of Chad and Cameroon to ignore their human rights obligations, giving them licence to claim that the agreements prevent them from taking measures that would adversely affect the project's profitability.[73]

The human rights context in Chad and Cameroon

Serious human rights violations in Chad and Cameroon have been documented by Amnesty International for more than three decades. In both countries the human rights of the population, be it communities living or working in the area of the pipeline or the wider population, are largely disregarded. Ineffective judicial systems are vulnerable to state interference and represent no match for powerful governments and commercial interests.

According to local groups, the operation of the oilfields and pipeline has already led to human rights abuses against many poor farmers in the Doba region of Chad who were denied access to their land, which ExxonMobil refused either to compensate them for or return to them. Several villages have reportedly been denied access to their sole safe water supply and the Kribi fishermen who work off Cameroon's coast have had their livelihoods seriously threatened by the pipeline. The concern is that the project's agreements open the door for further similar abuses for the duration of the project.

Recommendations

State-Investor Agreements must safeguard human rights

Amnesty International's analysis of the BTC and Chad-Cameroon pipeline agreements calls into question the role of international financial institutions, export credit agencies and commercial banks in financing such projects. At the very least the finance sector should use its leverage to ensure that:

- the Social and Environmental Impact Assessments (SEIAs) of the project include an analysis of the implications of the framework of legal agreements that underpin it.
- all project agreements include an explicit guarantee that nothing in the agreements can be used to undermine either the human rights obligations of the states or the human rights responsibilities of the companies that are party to them.
- all project agreements are compatible with the ability of individuals to obtain an effective judicial or other appropriate remedy, including reparations and compensation, for violations of their human rights stemming from the project.

Source: Amnesty International

CASE STUDY 7: Financing unsustainable development: the Trans Thai-Malaysia gas pipeline

Barclays breaches commitments to human rights and the environment with its role in Trans Thai-Malaysia Gas pipeline

The Trans Thai-Malaysia pipeline development is a collaborative enterprise between the state-owned oil companies Petronas of Malaysia and the Petroleum Authority of Thailand. The project is nearing completion and gas is already being pumped along the pipeline from the offshore fields in the Gulf of Thailand to a separation plant in the Chana district of Thailand. Here, commercial gas is to be extracted for sale in Thailand, while the rest will be transported via an 86-kilometre onshore pipeline to the Thai-Malaysian border to supply the Malaysian gas grid.[74]

Both the Thai government and the Trans Thai-Malaysia pipeline company (TTM), the company responsible for the development, claim that the pipeline will fuel industrialisation in southern Thailand, and will thus improve the local economy and reduce poverty and socio-economic disparities in the region. However, many people have expressed doubts as to whether local communities will reap any tangible benefits from the project.

The route of the pipeline also runs through important areas of wetland forest and some of the few remaining stretches of rare sand dune forest along the coast of southern Thailand. Villagers in the project area in Songkhla province, who are predominantly Muslim, earn their living through fishing, farming and rearing doves, and fears have been raised that the pipeline's construction will threaten food security in surrounding areas.[75] There are also concerns that it will give rise to harmful effluents and emissions that will threaten local livelihoods and have negative health impacts.

The role of Barclays Bank

In 2004, Barclays agreed to lead on the arrangement of finance for the pipeline. The bank has provided a loan of $257.1 million, nearly half of the total loan, giving it significant leverage over the project. The participation of Barclays has played a crucial role in attracting finance from other foreign investors. Barclays was also responsible for carrying out a satisfactory risk assessment for the project, ie to consider all problems associated with the project, including the potential for environmental and social harm.

Barclays is one of the four banks that led the way in the creation of the Equator Principles. These are environmental and social guidelines for banks involved in project finance and are based on policies developed by the World Bank and its private finance arm, the International Finance Corporation (IFC). A key requirement of the Equator Principles is that an Environmental Impact Assessment (EIA) involving mandatory public consultation is carried out on all projects to inform the final decision on project finance.

As a leading participant in the Business Leaders Group trialling the UN Norms on business and human rights, Barclays has also committed itself to responsibilities regarding human rights when involved in international project finance. The Barclays Group also adopted its own Statement on Human Rights in June 2004. This defines the bank's approach to human rights and its responsibilities. Regarding its commitment to local communities, Barclays states: 'We will take the necessary steps to understand the impacts that our business may have on the communities with which we interact, including human rights impacts. Where there is potential for our operations to cause human rights violations we will take whatever action is necessary to avoid them'.[76]

Environmental failures

The EIA carried out on the Trans-Thai Malaysian pipeline was heavily criticised for omitting many environmental and social impacts and is the subject of an administrative lawsuit.[77] The EIA was initially rejected by the Thai government's own expert panel and remained so for over a year.[78] However, pressure from the Thai government later resulted in its approval.

With regard to public consultation, two hearings took place in 2000, the second held because of the failure of the first. The second hearing was intended to take place over two days, but lasted only 25 minutes and was prejudiced against those members of the public in opposition to the pipeline as they were forcibly excluded from participating. Those who were permitted to comment at the consultation were employees of TTM.[79]

Human rights abuses

More than two years of peaceful and lawful protest against the pipeline by local people in southern Thailand has been met with threats of police violence and harassment and intimidation from security patrols in the area, creating what the UN Special Envoy on Human Rights, Hina Jilani, described as 'a climate of fear'.[80]

Despite numerous incidents of serious human rights abuses associated with the Trans-Thai Malaysia pipeline, Barclays continues its own association with the development. Its failure to take action is clearly in breach of its own human rights policy, and also its commitments under the Equator Principles and the pledges it has made as part of the Business Leaders Initiative on Human Rights.

A further concern for Barclays is the means by which TTM acquired certain areas of land required for the development. Public rights of way have disappeared in the Chana district, with project developers ignoring Thai law stipulating consultation with local residents. Villagers have also proved that TTM illegally acquired a strip of common beachfront in order to lay its gas pipeline onshore.[81] The National Human Rights Commission, an independent Thai body that assesses human rights concerns and abuses, recommended in December 2004 that the project be suspended until the issue was resolved.[82] However, construction continued and villagers' rights of way were blocked while Barclays maintained its silence and inaction on the issue.

The Barclays involvement in the Trans Thai-Malaysia pipeline demonstrates that participation in voluntary finance-sector CSR initiatives, such as the Equator Principles, does not guarantee real improvements in the protection of human rights and the environment.

Recommendations

- Friends of the Earth is calling on Barclays to report publicly on how it is implementing its commitments under the Equator Principles, and what action it is taking to address breaches of these commitments.

Source: Friends of the Earth

6. Conclusion

Many of the globe's least developed countries prettied themselves up as they were told to do, at great sacrifice… and still didn't receive an invitation to the global economic dance. Their trade did not expand dramatically, foreign investment in many cases did not flood in, and where it did arrive it often was focused on 'extractive industries' that used natural resources but did little to create jobs or spill over into broader economic growth. In fact, profits from the extraction of oil or iron ore or bauxite were frequently spirited out of developing countries and back to corporations in the industrialised north.[83]
The UN Conference on Trade and Development (UNCTAD), October 2005

Taken solely in numbers, the influence the finance sector has on every aspect of our lives can, at times, seem to dwarf the influence that governments have. One bank in the UK alone, the Royal Bank of Scotland, accounted for £600 billion in global assets in 2004, which is seven times the total flow of foreign direct investment to developing countries.[84]

The growth in capital markets has been reflected in a continuous increase in foreign direct investment, which has enabled companies to greatly extend their global reach in a way that has far-reaching implications for the environment, human rights and sustainable development. Given its scale, the damage that badly focused finance can have on issues such as biodiversity, cultural heritage, labour conditions and indigenous rights is enormous.

This report asks serious questions about the impacts of banks' operations in developing countries, but also aims to put the spotlight on the less well examined extent to which banks behave responsibly in OECD countries in which they are based. We have highlighted a range of circumstances where the finance sector not only fails to contribute to the sustainable development agenda, but in fact undermines global efforts to tackle the challenges of climate change, poverty and exclusion. From well-known instances of bribery and corruption, to a failure to support human rights in the countries they operate, responsible lending often seems to be a contradiction in terms.

While the finance sector has enormous influence, this must not override the responsibilities of governments to protect the public interest and to hold companies accountable for their actions. Yet so far, the EU and other governments around the world have shied away from exercising the necessary leadership to ensure that the finance sector does not continue to undermine global policy objectives. Instead, they have relied on weak efforts to promote 'corporate social responsibility' and a patchwork of voluntary initiatives that perpetuate an unsustainable system. With the UK occupying the EU Presidency, nothing appears to be changing. CSR in the finance sector is not a substitute for efficient and effective regulation.

In summary we recommend that:

- the EU and its member states adopt a rules-based approach to ensuring sustainable development objectives are upheld in the finance sector, with an effective monitoring and enforcement regime;
- the EU and its member states adopt a more inclusive approach to Company Law and require companies to be legally responsible for their social and environmental impacts both within the EU and overseas.

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Abbreviations

ABI	Association of British Insurers
ATCA	Alien Tort Claims Act
BBA	British Bankers' Association
BTC	Baku-Tbilisi-Ceyhan (oil pipeline)
CDP	the Carbon Disclosure Project
COP7	Conference of the Parties to the Climate Convention
CORE	Corporate Responsibility Coalition
CSR	corporate social responsibility
DTI	Department of Trade and Industry
ECGD	Export Credits Guarantee Department
EIA	Environmental Impact Assessment
ETS	Emissions Trading Scheme
FIs	financial institutions
FSA	Financial Services Authority
GDP	gross domestic product
IBAS	Independent Banking Advisory Service
IFC	International Finance Corporation
IFIs	international financial institutions
IMF	International Monetary Fund
IPCC	Intergovernmental Panel on Climate Change
KBR	Kellogg Brown and Root
LNG	liquefied natural gas
NGOs	non-governmental organisations
OECD	Organisation for Economic Cooperation and Development
PPI	payment protection insurance
SEIAs	Social and Environmental Impact Assessments
SIAs	State-Investor Agreements
TTM	Trans Thai-Malaysia pipeline company
UNCTAD	UN Conference on Trade and Development
UNEP	UN Environment Programme

For further details contact the

CORE Coalition
26-28 Underwood Street
London N17JQ

www.corporate-responsibility.org