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Banking with Labour Rights: Exploring the
Challenges of Mainstreaming Extra-Financial
Information into Financing Relationships

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Summary

The thesis presents the challenges involved in attempting to mainstream international labour rights standards into commercial financing relationships. In order to do so, it draws upon the financing relationships provided by the three most prolific banks in the coal-mining industry: BNP Paribas (France and England), Citi (United States of America) and Royal Bank of Scotland (Scotland).

It undertakes an assessment of the social responsibilities of financial actors through an analysis of the responsibilities of States and companies, under the United Nations “Protect, Respect and Remedy” Framework. In doing so, the particular nature of the financial sector and bank-client relationships are taken into account. The discussion on State duty raises questions on the extra-territorial obligations of States and the role of regulation within the sector. The analysis of corporate responsibilities demonstrates that the scope and character of the relationships and products give rise to differing constructions of social responsibility. Furthermore the consideration of extra-financial issues is shown as complementary to the fiduciary duty that firms owe their clients.

The analysis of the products provided by the three banks demonstrates that the crucial challenge to mainstreaming labour rights into their financing relationships is the establishment of a clear and effective stimulus, that is a “business case” for mainstreaming. On this basis, the thesis presents a “business case” model and framework which is then applied to the current efforts and initiatives of the banks selected.

Keywords: *Labour Rights, Commercial Banking, finance, United Nations "Protect, Respect and Remedy" Framework, John Ruggie, mainstreaming, environmental and social integration, international law.*

Preface

It is a widely held fact that commercial banks, by their very nature, play an important role in society. As external financing agents that provide capital to companies, they hold a unique position within the human rights and business field, and are potentially able to serve as agents for change by mainstreaming labour rights standards into their financing relationships. However such efforts are complicated by the nature of the product that they provide. This thesis represents an effort to present the particular challenges that a commercial bank faces when attempting to implement such efforts.

I would like to take this opportunity to thank my supervisor, Radu Mares, whose guidance has played a pivotal role in not only encouraging my interest in the field but also shaping my thoughts and understandings of the challenges within it.

In addition, a note of appreciation must be expressed for the human rights and business professionals who took the time to meet with me and discuss the development of my thesis topic.

I would also like to extend a special note of thanks to my family, friends and peers, whose support and company has provided me with an immeasurable source of inspiration and drive throughout my studies.

Abbreviations

CSR	Corporate Social Responsibility
EAI	Enhanced Analytics Initiative
E&S	Environmental and Social
ESG	Environmental, Social and Corporate Governance
ESMS	Environmental and Social Management System
FI	Financial Intermediary
GPs	Guiding Principles on Business and Human Rights: Implementing the United Nations “Protect, Respect and Remedy” Framework
IFC	International Finance Corporation
ILO	International Labour Organization
RBS	Royal Bank of Scotland Group
PS	International Finance Corporation’s Performance Standards on Social and Environmental Sustainability
SRI	Socially Responsible Investment
SRSG	Special Representative of the United Nations’ Secretary-General on the issue of human rights and transnational corporations and other business enterprises, Professor John Ruggie
UDHR	Universal Declaration of Human Rights
UN	United Nations
UNEP FI	United Nations Environment Programme Finance Initiative
UN GA	United Nations General Assembly
UN HRC	United Nations Human Rights Council
UN PRI	United Nations Principles of Responsible Investment

1 Introduction

There is no single silver bullet solution to business and human rights challenges. There are only many small ones. And if all players that considered themselves to be just one part of the solution were to do nothing, then nothing would ever change.

John Ruggie¹

1.1 Background

Commercial banks, as a form of financial intermediaries (“FIs”), provide an invaluable source of financing for companies in numerous sectors. As a FI, a bank raises money from investors and repackages this cash supply to match the financing demands of borrowers. If one were to extend this line of thought, it is clear that this provision of financing grants companies the resources, to undertake and/or extend operations, which would otherwise not be possible. These operations, in turn, may lead to certain positive outcomes, such as the creation of jobs for residents, and/or negative impacts, such as the violation of the labour rights of workers, on the community that the company is operating in. Traditionally, the act of providing finance has been viewed as neutral, as commercial banks have supposedly remained removed from the operations and decision-making processes of the companies that they finance. However a rethinking of the role of businesses in light of globalisation, as well as a new understanding of the financing relationships between banks and their clients has led to the realisation that commercial banks hold a unique position within the human rights and business field; as not only actors that are potentially complicit in the labour rights violations of companies, but also as agents for change that are able to mainstream labour rights standards into their financing relationships and thereby promote the observance of labour rights in their clients’ operations.²

Whilst the State is undoubtedly the primary duty-bearer in respect to promoting and realising the human rights of those within its jurisdiction, it is nonetheless well established that companies play an important role in

* The thesis follows the Oxford University Standard for Citation of Legal Authorities (4th edn).

¹ John Ruggie, ‘Engaging Export Credit Agencies in Respecting Human Rights’ (OECD Export Credit Group’s “Common Approaches” Meeting, Paris, 23 June 2010) 5-6.

² In regards to the wording employed within the human rights and business field, the latter point expressed in the sentence refers to the concept of the ‘sphere of influence’. That is that a financial provider is able to have a positive impact/influence on its clients.

ensuring respect for human rights and labour rights.³ Hence it is critical that companies pay due attention and respect to international human rights standards within their operations and activities.⁴ This notion of corporate social responsibility (“CSR”) is by no means a new phenomenon,⁵ albeit traditionally businesses have been considered to hold a monofunctional role as contributors to the economic growth of society; that is as producers of goods and services and a means for employment creation.⁶ However the advent of globalisation⁷ and subsequent market expansion, has affected the way communities around the world, have come to view companies and their role in society.⁸

The definition of CSR, and indeed acceptance of the term, remains unsettled within the international community as understandings of the concept differ according to the parties referring to it and their purposes.⁹

³ Consider the standing and weight allocated to employers as a consequence of the International Labour Organization’s tri-partite structure.

⁴ UN HRC ‘Protect, Respect and Remedy: a Framework for Business and Human Rights, Report of the Special Representative of the Secretary-General on the issue of human rights and transnational corporations and other business enterprises, John Ruggie,’ (07 April 2008) A/HRC/8/5 para 104; UN HRC ‘Guiding Principles on Business and Human Rights: Implementing the United Nations “Protect, Respect and Remedy” Framework, Report of the Special Representative of the Secretary-General on the issue of human rights and transnational corporations and other business enterprises, John Ruggie,’ (21 March 2011) A/HRC/17/31 Introduction.

⁵ The roots of which have been traced back to the 17th and 18th centuries, in which the Quaker movement expressed their interest in business as being to add value to their workforce and society, as opposed to solely being concerned with profits. John Hancock, *Investing in Corporate Social Responsibility: A Guide to Best Practice, Business Planning and the UK's Leading Companies* (Kogan Page Publishers, 2005) 5, 150, 289.

⁶ Milton Friedman, ‘The Social Responsibility of Business Is to Increase its Profits’ (New York Times Magazine, 13 September 1970) 122–126; Andrew Gamble, & Gavin Kelly, ‘Shareholder value and the stakeholder debate in the UK’, (2001) 9(2) *Corporate Governance: An International Review*, 110-117 <<http://onlinelibrary.wiley.com>> accessed 5 March 2012.

⁷ Defined as ‘the closer integration of the countries and peoples of the world which has been brought about by the enormous reduction of costs of transportation and communication, and the breaking down of artificial barriers to the flow of goods, services, capital, knowledge, and (to a lesser extent) people across borders’. Joseph E. Stiglitz, *Globalization and Its Discontents* (Norton & Company, 2002) 9ff.

⁸ United Nations Human Rights Council (UN HRC), ‘Protect, Respect and Remedy: a Framework for Business and Human Rights, Report of the Special Representative of the Secretary-General on the issue of human rights and transnational corporations and other business enterprises, John Ruggie,’ (07 April 2008) A/HRC/8/5 para 104; UN HRC ‘Guiding Principles on Business and Human Rights: Implementing the United Nations “Protect, Respect and Remedy” Framework, Report of the Special Representative of the Secretary-General on the issue of human rights and transnational corporations and other business enterprises, John Ruggie,’ (21 March 2011) A/HRC/17/31 Introduction; Alyson Warhurst, ‘Future Roles of Business in Society: The Expanding Boundaries of Corporate Responsibility and A Compelling Case for Partnership’ (2005) 37(2-3) *Futures*, 151-168 <www.sciencedirect.com> accessed 10 March 2012.

⁹ That is the labelling or references to the concept has evolved to reflect these differences with parties opting for various terms that suit their understanding of the concept; some

The World Bank holds that CSR may be generally defined as:

- A collection of policies and practices linked to: a relationship with key stakeholders, values, compliance with legal requirements, and respect for people, communities and the environment; and
- The commitment of business to contribute to sustainable development.¹⁰

In 2011, the European Commission, revised its definition of CSR to read as ‘the responsibility of enterprises for their impacts on society’. In order to fully meet these responsibilities, enterprises are required to:

have in place a process to integrate social, environmental, ethical, human rights and consumer concerns into their business operations and core strategy in close collaboration with their stakeholders, with the aim of:

- Maximising the creation of shared value for their owners/shareholders and for their other stakeholders and society at large; and
- Identifying, preventing and mitigating their possible adverse impacts.¹¹

The International Organization for Standardization defines CSR as the:

responsibility of an organisation for the impacts of its decisions and activities on society and the environment, through transparent and ethical behaviour that: contributes to sustainable development including health and the welfare of society; takes into account the expectations of stakeholders; is in compliance with applicable law and consistent with international norms of behaviour; and is integrated throughout the organisation and practised in its relationships.¹²

Irrespective of the varying points of view a clear distinction is drawn, by all, as to the difference between CSR and corporate philanthropy. On the one

examples being corporate responsibility, corporate citizenship, sustainability, the triple bottom line, business ethics, social responsibility.

¹⁰ Djordjija Petkoski, Michael Jarvis and Gabriela de la Garza, ‘The Private Sector as a True Partner in Development’ (The International Bank for Reconstruction and Development/The World Bank/World Bank Institute 2006) <<http://www.worldbank.org/>> accessed 8 March 2012.

¹¹ European Commission, ‘A renewed EU strategy 2011-14 for Corporate Social Responsibility, Brussels’ (Communication) COM(2011) 681 final.

¹² International Organization for Standardization, ‘ISO 26000: Guidance on Social Responsibility’ (2010) Clause 2.18.

hand, CSR refers to policies and actions, which are ‘integrated into an enterprise’s core business strategy and become a critical part of the long-term wealth creation process, sustainability of profits, and value generation’ whereas philanthropy is understood to be external to the everyday operations and activities of the business.¹³ In addition it is important to note that companies are increasingly assessed through the lenses provided by the stakeholder approach; whereby employees, investors and consumers hold a stake in company operations.¹⁴ As a direct consequence, greater expectations are being placed on the conduct of companies and their responsibilities in respect to actions and operations that may impact on the social and physical environment of society.

1.2 Research Focus

The thesis examines the challenges involved in mainstreaming labour rights considerations into commercial financing relationships. In order to do so, the following questions will be posed: Do commercial banks have a responsibility to apply international labour standards to their financing relationships? How can labour rights standards be integrated into commercial financing relationships? What are the challenges involved in attempting to mainstream integration? And what steps, if any, are currently being taken by banks to meet these challenges?

The focus of the research will be on the provision of financing relationships to companies operating solely within the coal-mining sector.¹⁵ The author has chosen to use the coal-mining sector as the operating example due to the availability of information on the forms of financial products supplied by commercial banks to companies within the sector. However the intention is that the analysis may be used for all commercial financing relationships, irrespective of the sector in which the clients operate.

It will explore the social responsibilities that apply to financial institutions, through both a general and sector-specific analysis. The thesis will examine the various financial products supplied by the commercial banks and

¹³ Djordjija Petkoski, Michael Jarvis and Gabriela de la Garza, ‘The Private Sector as a True Partner in Development’ (The International Bank for Reconstruction and Development/The World Bank/World Bank Institute 2006) <<http://www.worldbank.org/>> accessed 8 March 2012.

¹⁴ This approach builds upon the definition established by Freeman that defines stakeholders as ‘any group or individual who can affect or is affected by the achievement of the organization’s objectives’. R. Edward, Freeman ‘Strategic Management: A Stakeholder Approach’ [1984] (Pitman) 5; Alyson Warhurst, ‘Future Roles of Business in Society: The Expanding Boundaries of Corporate Responsibility and A Compelling Case for Partnership’ (2005) 37(2-3) *Futures*, 151-168 <www.sciencedirect.com> accessed 10 March 2012.

¹⁵ As opposed to companies which operate in both coal-electricity and coal-mining.

elaborate on the effect that they have in respect to defining the bank-client relationship and potential obligations of commercial banks. As an example, an analysis of the integration of international labour standards into the financial products offered by three commercial banks will be offered.

The thesis will disregard any financing relationships involving project financing or other products where the provision of finance is targeted towards a known purpose. This decision was made on the grounds that these forms of finance constitute less than five percent of all financing relationships provided by commercial or investment lending institutions and considerable attention has been paid to the integration of extra-financial information into these relationships.¹⁶

1.3 Methodology And Materials

In order to answer the research questions, the author has adopted an interdisciplinary research approach. The information and findings presented are drawn from research and developments within numerous fields, such as international human rights law, finance and accounting, and national commercial law.¹⁷

The thesis will rely upon the International Labour Organization's ("ILO") core labour standards; reports by various non-governmental organisations, such as the study on the financing relationships in the coal-mining sector; reports by inter-governmental organisations, such as those published by the United Nations ("UN") Special Representative of the Secretary General on the issue of human rights and transnational corporations and other business enterprises ("SRSG"), Professor John Ruggie; reports published by the surveyed banks, as established by the study on coal-mining; academic doctrine, such as scholarly articles and textbooks; and when relevant, reportage and interviews with financial professionals.¹⁸

¹⁶ On account of these relationships being predominantly financed through non-recourse loans, which makes tracking funds allocated by banks and the monitoring of the implementation of human rights standards relatively straightforward for lenders. BANKTrack, 'Banking it Right; The "Protect, Respect and Remedy" framework applied to bank operations' (5-6 October 2009) BANKTrack Submission to the OHCHR consultation on operationalizing the framework for business and human rights presented by the Special Representative of the Secretary-General on the issue of human rights and transnational corporations and other business enterprises, 6 <<http://www2.ohchr.org/english/issues/>> accessed 02 April 2012.

¹⁷ National commercial law refers to the regulations imposed, by the jurisdictions surveyed, on companies/financial institutions that are registered in their territory.

¹⁸ Following the compilation of publicly available material, the three banks were invited to discuss the findings through desk research. The interviews mentioned refer to conversations held between the author and the Royal Bank of Scotland.

A material of key importance for this thesis is the study, *Bankrolling Climate Change: A Look into the Portfolios of the World's Largest Banks*.¹⁹ The study examined the portfolios of 104 of the largest international banks and 31 of the biggest coal-mining companies. The coal-mining companies were selected following a review of their 2010 coal production in million tons and a company quota was imposed per country in order to reflect a geographical spread across the different world's regions. The collated data was drawn from information available in the companies' annual reports, stock exchange filings and various other publications, such as trade and financial releases and databases on the financial transactions between the aforementioned banks and companies.

As previously mentioned, the thesis examines the policies and measures taken by three most prolific banks' on the integration of social issues. Thus it should be noted that the research on the approaches of the banks selected relies predominantly upon reports and material published by the banks over the past seven years. Furthermore it is acknowledged that the information may suffer from the self-reporting bias.

1.3.1 The Financing Relationships/Products

The thesis will concentrate on general forms of debt financing and equity financing. A distinction will be drawn between the two different categories of financing thereby allowing the reader to understand how the role and responsibilities of banks differ according to the nature of their financing relationship with the companies in question.

Debt financing is, in short, when the company raises operating capital through borrowing. The lender becomes a creditor and expects the sum lent to be paid back, usually along with interest. Examples of this type of financing within the coal-mining sector are bonds, corporate loans and revolving credit facilities. The thesis will concentrate on the difficulties of applying international labour standards to bonds in general and in doing so will take into account the difference between the bank's status as a bondholder and bond issuer. In contrast to debt financing, the lender in equity relationships is given shares of stocks in the company, in exchange for their investment sums. Consequently they are considered to be part owners of the company.

¹⁹ Heffa Schücking, Lydia Kroll, Yann Louvel and Regine Richter, 'Bankrolling Climate Change: A Look Into the Portfolios of the World's Largest Bank' (urgewald, groundWork, Earthlife Africa Johannesburg, BANKTrack, December 2011).

1.3.2 The Banks

The study of the application of the core labour standards will be undertaken with due consideration for the approach and guidance proffered by the International Finance Corporation (“IFC”). As the objective is to discuss the mainstreaming of labour standards into banking practices, the author has chosen to focus on commercial entities that have the broadest market presence within the sector. Thus the decision has been taken to assess the three banks, which have the greatest number of financing relationships rather than examining those which hold the greatest market capital for shares. These include BNP Paribas²⁰, Citi²¹ and the Royal Bank of Scotland (“RBS”)²². The decision was taken to exclude Morgan Stanley on the premise that the thesis focuses on commercial banking entities and not institutions that only provide investment-banking services.

1.4 Structure

The Second Chapter will expand on the responsibilities of FIs. It will do this through an examination of the first two pillars of the “Protect, Respect and Remedy” Framework: Pillar I regarding the obligations of States and Pillar II regarding corporate responsibilities. The enquiry of the relevant aspects of State responsibility is intended to shed light on the legal obligations that banks may be subjected to by the States that they are headquartered in. In contrast, the discussion on Pillar II is an analysis of the direct responsibilities that apply to commercial banks.

Chapter Three will provide a brief description of each financial product and examine whether the products contain inherent challenges, which might impede the mainstreaming of labour rights considerations. Following which, an analysis will be conducted of the general challenges of mainstreaming labour rights into the financial sector.

Chapter Four will build off the previous chapters by exploring the practices of the three selected banks. The Chapter intends to provide evidence of banks’ efforts to recognise the responsibilities highlighted in Chapter Two

²⁰ Established 75 financing relationships through the following subsidiaries: BancWest, BGL, Fortis, Shinhan BNP Paribas Asset Management Co (50 percent ownership), and TKB BNP Paribas Investment Partners OAO (50 percent owned).

²¹ Entered into 72 financing relationships through the following subsidiaries: Bank Handlowy W Warszawie SA and Triton Insurance Company.

²² The Royal Bank of Scotland supplied 72 financing relationships through ABN AMRO, Citizens Financial Group, Coutts & Company, Greenwich Capital, NatWest, Royal Bank of Scotland, Royal Bank of Scotland Coutts Bank and Ulster Bank.

and to meet the challenges as highlighted under Chapter Three.

The final Chapter is dedicated to conclusions, including the challenges faced in mainstreaming labour rights into financing relationships in coming years.

2 The Social Responsibilities Of Financial Actors

Admittedly within the debate on corporate social responsibility, the financial sector has been relatively late to the scene; with the scant discussion resting on particular financing relationships, such as project finance, and environmental issues and/or other challenges related to sustainable development.²³ This Chapter will chart the development of the responsibilities of financial actors by examining the establishment of an international framework on corporate responsibility for all businesses, and the applicable international standards and sector-specific voluntary initiatives. It will then build upon the internationally endorsed framework by using it as a matrix to specifically examine the responsibilities placed on financial actors.

2.1 Development Of A Framework For Corporate Social Responsibility

Prior to the adoption of the UN “Protect, Respect and Remedy” Framework (“the Framework”), the human rights and business debate lacked an authoritative focal point, upon which stakeholders were able to build their thoughts and actions.²⁴ The subsequent result being that ‘claims and counter-claims proliferate[d], initiatives abound[ed], and yet no effort reache[d] significant scale’.²⁵ The Framework has come to be recognised, by the international community, as a new global standard on business responsibility for human rights and as such provides an authoritative matrix for the responsibilities that corporations and States are subject to.²⁶

²³ Sustainable Development being commonly defined as ‘meeting the needs of the present without compromising the ability of future generations to meet their own needs’. UNGA ‘Report of the World Commission on Environment and Development’ 96th Plenary Meeting (11 December 1987) UN Doc A/Res/42/187; Marcel Jeucken, *Sustainability in Finance; Banking on the Planet* (Eburon Academic Publishers, 2004) 11-79; Michael Blowfield and Alan Murray, *Corporate responsibility; A Critical Introduction*, (Oxford University Press, 2008) 245; IFC, ‘Banking on Sustainability’ (IFC, January 2007) 3 <www1.ifc.org> accessed 7-10 March 2012.

²⁴ UN HRC ‘Protect, Respect and Remedy: a Framework for Business and Human Rights, Report of the Special Representative of the Secretary-General on the issue of human rights and transnational corporations and other business enterprises, John Ruggie,’ (07 April 2008) A/HRC/8/5, Introduction, paras 5 and 8.

²⁵ *ibid* para 5.

²⁶ In June 2011, the United Nation Human Rights Council unanimously endorsed and adopted the GPs. United Nations General Assembly (UN GA), ‘Human rights and transnational corporations and other business enterprises’ (06 July 2011) 17th Session UN Doc A/HRC/RES/17/4; UN HRC ‘Guiding Principles on Business and Human Rights: Implementing the United Nations “Protect, Respect and Remedy” Framework, Report of

Subsequently a number of the initiatives aimed at businesses have been updated to reflect this development.²⁷

The Framework is based on three pillars, which encapsulate the following core principles:

- 1) The State duty to protect against human rights abuses by third parties, including business, through appropriate policies, regulation, and adjudication;²⁸
- 2) The corporate responsibility to respect human rights, which in essence means to act with due diligence to avoid infringing on the rights of others; and
- 3) Greater access by victims to effective remedy, judicial and non-judicial.²⁹

The Guiding Principles for the Implementation of the UN “Protect, Respect and Remedy” Framework (“GPs”) represents practical guidance and recommendations on the implementation of the three-pillar policy, introduced by the Framework.³⁰ They are not binding international law however they provide authoritative recommendations to all businesses on the management of the human rights impacts of their operations. Furthermore they establish the relevance and applicability of human rights principles, as established by the International Bill of Rights and the “core” labour standards, to company operations.³¹

the Special Representative of the Secretary-General on the issue of human rights and transnational corporations and other business enterprises, John Ruggie,’ (21 March 2011) A/HRC/17/31 Introduction.

²⁷ Eg consider the clarification of the relevance of the UN “Protect, Respect and Remedy” Framework for the UN Global Compact, the 2011 update of the OECD Guidelines for Multinational Enterprises and the 2009-2011 review of the IFC’s sustainability framework. UN Global Compact, ‘UN Framework’

<http://www.unglobalcompact.org/issues/human_rights/The_UN_SRSG_and_the_UN_Global_Compact.html> accessed 07 June 2012; The Organisation for Economic Co-operation and Development (OECD), ‘Consultation on the Guidelines for Multinational Enterprises and the UN “Protect, Respect and Remedy” Framework’

<http://www.oecd.org/document/36/0,3746,en_2649_34889_46078244_1_1_1_1.00.html> accessed 07 June 2012; IFC, ‘UN Guiding Principles on Business and Human Rights and IFC Sustainability Framework’ <www1.ifc.org> accessed 20 June 2012.

²⁸ Note a distinction is drawn between the widely established international law principle on a State’s responsibility to protect as opposed to the “responsibility to protect” principle as recognised under international humanitarian law.

²⁹ UN HRC, ‘Business and human rights: Towards operationalizing the “protect, respect and remedy” framework: report of the Special Representative of the Secretary-General on the issue of human rights and transnational corporations and other business enterprises*’ (22 April 2009) A/HRC/11/13 Introduction.

³⁰ UN HRC ‘Guiding Principles on Business and Human Rights: Implementing the United Nations “Protect, Respect and Remedy” Framework, Report of the Special Representative of the Secretary-General on the issue of human rights and transnational corporations and other business enterprises, John Ruggie,’ (21 March 2011) A/HRC/17/31 Introduction.

³¹ *ibid* Pillar II, s A, para 12.

2.1.1 International Human Rights Standards

The International Bill of Rights consists of the ‘Universal Declaration of Human Rights (“UDHR”) and the main instruments through which it has been codified: the International Covenant on Civil and Political Rights (“ICCPR”) and the International Covenant on Economic, Social and Cultural Rights (“ICESCR”).³² As a measure which was adopted by the UN General Assembly, the UDHR is not considered to be legislative in nature³³ and as such is ‘soft law’.³⁴ In spite of this, the focus of this particular section shall be on the UDHR as the Declaration contains the foundations for the human rights principles, which were later divided amongst the aforementioned Covenants. The principles of the UDHR that are of interest are those related to the “core” labour standards, which have been subsequently provided for in the ICCPR, ICESCR and ILO instruments.³⁵ The Declaration is admittedly directed towards Governments. However the wording of the instrument makes it clear that:

every organ of society, [is to keep] this Declaration constantly in mind [and] strive by teaching and education to promote respect for these rights and freedoms and by progressive measures, national and international, to secure their universal and effective recognition and observance, both among the peoples of Member States themselves and among the peoples of territories under their jurisdiction.³⁶

Historically speaking, the ILO was hesitant to classify its instruments containing labour standards³⁷ as human rights instruments, in spite of the standards touching upon various international human rights law subjects.

³² *ibid.*

³³ Charter of the United Nations (signed on 26 June 1945, entered into force 12 June 1968) Chapter IV, art 10.

³⁴ Malcolm D. Evans, *International Law* (2nd edn, Oxford University Press 2006) 142 and 151.

³⁵ Universal Declaration of Human Rights (adopted 10 December 1948 UNGA Res 217 A(III) (UDHR) arts 4, 7, 20, 23 and 24; International Covenant on Economic, Social and Cultural Rights (adopted 16 December 1966, entered into force 3 January 1976) 993 UNTS 3 (ICESCR) arts 7, 8 and 10; International Covenant on Civil and Political Rights (adopted 16 December 1966, entered into force 23 March 1976) 999 UNTS 171 (ICCPR) arts 8, 22 and 26.

³⁶ Universal Declaration of Human Rights (adopted 10 December 1948 UNGA Res 217 A(III) (UDHR) Preamble.

³⁷ The ILO standards are a body of international conventions and recommendations, which have been drawn up by representatives of governments, employers and workers, dealing with subjects relating to labour law. International Labour Organization (ILO), ‘Social Justice’

<<http://www.ilo.org/global/standards/introduction-to-international-labour-standards/need-for-social-justice/lang--en/index.htm>>; ILO, ‘Conventions and Recommendations’ <<http://www.ilo.org/global/standards/introduction-to-international-labour-standards/conventions-and-recommendations/lang--en/index.htm>> accessed on 20 April 2011.

However in 1998, the ILO through the Declaration on Fundamental Principles and Rights at Work³⁸ identified the following subjects as fundamental rights:

- (a) Freedom of association and the effective recognition of the right to collective bargaining;
- (b) The elimination of all forms of forced or compulsory labour;
- (c) The effective abolition of child labour; and
- (d) The elimination of discrimination in respect of employment and occupation.³⁹

As a consequence, the eight ILO standards that embody these particular rights have received an elevated status and are considered to constitute the “core” standards of the ILO. In spite of its nature as a soft-law instrument, the Declaration commits all ILO member States to take measures to respect, promote and realise the aforementioned rights, regardless of whether they have ratified the relevant conventions or not.⁴⁰

2.1.2 Sector-Specific Initiatives

The human rights and business field is host to the proliferation of a number of different initiatives and codes of conduct. As mentioned, prior to the establishment of the GPs and as a response to the increased demands by society, this multitude of initiatives illustrated a push by the business and international community to establish a set of norms to assist companies in their observance and application of human rights principles in their operations. The measures have taken the form of both general initiatives aimed at all businesses, regardless of the sector they operate in, as well as sector-specific programmes. The examples given below are a non-exhaustive list of the most important sector-specific initiatives, which commercial banks are involved in.

Most of the initiatives aimed at the financial sector have focused on particular areas rather than on attempts to mainstream human rights concerns into financing relationships.⁴¹ In addition a niche market, known as socially responsible investing (“SRI”), which focuses on streaming environmental and social (“E&S”) concerns into financing relationships, has developed within the financial sector. However SRI is primarily undertaken

³⁸ ILO, Declaration on Fundamental Principles and Rights at Work (adopted 18 June 1998 86th session).

³⁹ *ibid* art 2.

⁴⁰ International Organisation of Employers, ‘The ILO Declaration on Fundamental Principles and Rights At Work’ (January 2006) IOE Position Paper, 1 <<http://www.ioe-emp.org/>> accessed 28 April 2011; Lee Swepston, ‘International Labour Organization and Human Rights’ in Catarina Krause and Martin Scheinin (eds), *International Protection of Human Rights* (Åbo Akademi University, 2009) 11.

⁴¹ Eg, project financing.

by institutional investors or is offered by financial institutions as an alternative option to general investment courses.

Equator Principles

The Equator Principles is considered to be the benchmark that FIs use to assess and manage E&S risks in project financing relationships.⁴² However it is noted that some financial institutions are now applying the principles to other forms of financing relationships.⁴³ These principles are largely based on the IFC's Performance Standards ("PS") and the World Bank Group's Environmental, Health and Safety Guidelines.⁴⁴ The Equator Principles have been adopted by all the commercial banks considered in the thesis.

Principles Of Responsible Investment

Another approach that may be taken into account by investors is the UN endorsed Principles of Responsible Investment ("UN PRI").⁴⁵ The UN PRI is a framework developed by institutional investors to assist investors in the incorporation and application of environmental, social and corporate governance ("ESG") issues into 'decision-making and ownership practices'.⁴⁶ Of the banks surveyed by the thesis, only BNP Paribas is a signatory to the UN PRI.

The International Finance Corporation

The IFC constitutes part of the World Bank Group and is its private sector lending arm. It is considered to be the world's largest development institution; with close to a third of all private sector financing in developing countries being provided by them.⁴⁷ As a recognised development institution, it specifically aims to:

further economic development by encouraging the growth of productive private enterprise in member countries, particularly in the less developed areas, thus supplementing the activities of the International Bank for Reconstruction and Development ... In carrying out this purpose, the Corporation shall:

⁴² Equator Principles, 'Equator Principles' <<http://www.equator-principles.com/>> accessed 02 April 2012.

⁴³ Adrienne Margolis, 'Equator Principles' (2010) 6 No. 2 IHPERSP 13 <www.westlawinternational.com> accessed 18 December 2011.

⁴⁴ Equator Principles, 'Equator Principles' <<http://www.equator-principles.com/>> accessed 02 April 2012.

⁴⁵ United Nations Principles of Responsible Investment (UN PRI) <<http://www.unpri.org/>> accessed 21 March 2012.

⁴⁶ *ibid.*

⁴⁷ In 2011, the IFC reported that they provided close to \$19 billion in private sector financing. IFC, 'I am Opportunity: IFC Annual Report' (2011) 3; The World Bank, 'About Us' <<http://web.worldbank.org>> accessed 02 April 2012.

- (i) In association with private investors, assist in financing the establishment, improvement and expansion of productive private enterprises which would contribute to the development of its member countries by making investments, without guarantee of repayment by the member government concerned, in cases where sufficient private capital is not available on reasonable terms;
- (ii) Seek to bring together investment opportunities, domestic and foreign private capital, and experienced management; and
- (iii) Seek to stimulate, and to help create conditions conducive to, the flow of private capital, domestic and foreign, into productive investment in member countries.⁴⁸

Since 2006, the IFC has been applying their Policy on Social and Environmental Sustainability and PS to investment projects.⁴⁹ There are eight PS, which cover a range of issues and concerns arising from development projects. PS Two and its corresponding Guidance Note establish guidelines on labour and working conditions. These guidelines are ‘in part guided by a number of international conventions and instruments, including those of the ILO and UN’.⁵⁰ In addition to their recently revised PS serving as a point of reference for initiatives such as the Equator Principles, the organisation provides various advisory and financial products to Governments and companies, including FIs that are involved in commercial banking.⁵¹ Hence the IFC’s role in the social responsibility matrix cannot be understated.

2.2 The United Nations “Protect, Respect and Remedy” Framework

As Professor Ruggie explained, the three pillars are, by their nature, intended as differentiated but complementary responsibilities.⁵² Each pillar represents an important component in the construction of the human rights

⁴⁸ International Finance Corporation (IFC), ‘Articles of Agreement’ (as amended on April 28, 1993) art 1.

⁴⁹ IFC, ‘IFC Sustainability’ <www.ifc.org/sustainability> accessed 02 April 2012.

⁵⁰ See text to nn 37-40 for a description of the ILO standards referenced are the “core” labour standards. IFC, ‘Performance Standards on Environmental and Sustainability’ (1 January 2012) <www1.ifc.org> accessed 7-10 March 2012.

⁵¹ IFC, ‘Advisory Services’ <http://www1.ifc.org/wps/wcm/connect/AS_EXT_Content/What+We+Do/Advisory+Services/> accessed 02 April 2012.

⁵² UN HRC ‘Protect, Respect and Remedy: a Framework for Business and Human Rights, Report of the Special Representative of the Secretary-General on the issue of human rights and transnational corporations and other business enterprises, John Ruggie,’ (07 April 2008) A/HRC/8/5 para 9.

responsibilities of States and businesses. As set out above, the first two pillars establish the duties of States and responsibilities of companies. The third pillar provides cohesion to the Framework by confirming the need for access to remedies, as ‘even the most concerted efforts [by States or corporations] cannot prevent all abuse’.⁵³ Access to remedy, addresses both States and businesses by calling upon them to establish effective judicial and non-judicial mechanisms that victims may use to address the human rights impacts of companies.⁵⁴ Thus access to remedy is seen to fall within the ambit of the first two pillars and will not be further discussed within this Chapter.

2.2.1 Pillar I: The State Duty To Protect Human Rights

Pillar I of the Framework embodies the principle that States have a ‘duty to protect against human rights abuses committed by third parties, including business’.⁵⁵ This principle encapsulates steps taken by States to ‘prevent, punish and redress such abuse through effective policies, legislation, regulations and adjudication’.⁵⁶ The inclusion of the Pillar within this Chapter is intended as an analysis of the human rights responsibilities placed on financial actors via a discussion of the obligations of Home States.⁵⁷

It is evident that States have a duty to act when human rights in the Home State are infringed. However the case is not as clear-cut when human rights are infringed outside the direct control of the State and in the territory of the State hosting the companies operations (“Host State”). The latter issue as to extraterritorial obligations raises considerable concerns by Home States on their grounds for justifying an intervention in the internal affairs of other States.

⁵³ *ibid.*

⁵⁴ The state duty to protect establishes that ‘states take all necessary steps to protect against such abuse, including to prevent, investigate, and punish the abuse, and to provide access to redress’. In addition The Framework highlights that these mechanisms are understood to be measures that victims are able to use to bring abuses to the ‘attention of the company and seek remediation, without prejudice to legal channels available’, and as such are considered to be ‘part of the corporate responsibility to respect’. *ibid* paras 18, 26, 93.

⁵⁵ *ibid* introduction, para 9.

⁵⁶ UN HRC ‘Guiding Principles on Business and Human Rights: Implementing the United Nations “Protect, Respect and Remedy” Framework, Report of the Special Representative of the Secretary-General on the issue of human rights and transnational corporations and other business enterprises, John Ruggie,’ (21 March 2011) A/HRC/17/31 para I.A.1.

⁵⁷ That is, States that the companies are headquartered in.

Extraterritorial Obligations Of States

The basic premise of international human rights law is that individual States are responsible for the protection and promotion of the rights of those living within their territory. However the international community is increasingly becoming aware that the steadfastness of the premise is debateable in the age of ever-increasing globalisation, relaxed economic borders and a corresponding weakening of State sovereignty and governance. Increasing recognition is being given to the need for States to work together through co-operative measures to achieve the realisation of certain human rights where a State is either unable or incapable of meeting their human rights obligations and/or enforcing such obligations effectively.⁵⁸

The extraterritorial obligations of States refers to the theory that States should extend their jurisdiction to respect and protect the human rights of those located outside their physical territory. In accordance with the legal instruments highlighted above, the legal standing for this principle may be derived from the UDHR, and is duly reinforced by the ICCPR and the ICESCR.

The preamble of the UDHR establishes the instrument:

as a common standard of achievement for all peoples and all nations, to the end that every individual and every organ of society, keeping this Declaration constantly in mind, shall strive by teaching and education to promote respect for these rights and freedoms and by progressive measures, national and international, to secure their universal and effective recognition and observance, *both among the peoples of Member States themselves and among the peoples of territories under their jurisdiction.*⁵⁹

The ICCPR upholds this principle and states, in Article 2(1), that each:

State Party to the present Covenant undertakes to respect and to ensure to *all individuals within its territory and subject to its*

⁵⁸ Consider the United Nations Millennium Project and its subsequent campaign, the development of the Responsibility to Protect Doctrine. Narula Smita, 'International Financial Institutions, Transnational Corporations and Duties of States' (2011) New York University Public Law and Legal Theory Working Papers Paper 298 1 <http://lsr.nellco.org/nyu_plltwp/298> accessed 18 February 2012; UN HRC 'Protect, Respect and Remedy: a Framework for Business and Human Rights, Report of the Special Representative of the Secretary-General on the issue of human rights and transnational corporations and other business enterprises, John Ruggie,' (07 April 2008) A/HRC/8/5 Introduction and s.1.

⁵⁹ Universal Declaration of Human Rights (adopted 10 December 1948 UNGA Res 217 A(III) (UDHR) Preamble (emphasis added).

jurisdiction the rights recognized in the present Covenant, without distinction of any kind.⁶⁰

Article 2(1) of the ICESCR provides that State parties will undertake:

steps, individually and through international assistance and co-operation, especially economic and technical, to the maximum of its available resources, with a view to achieving progressively the full realization of the rights recognized in the present Covenant by all appropriate means, including particularly the adoption of legislative measures.⁶¹

In spite of the ICESCR not expressly stating that it has extraterritorial effect, it should be noted that Vienna Convention of Treaties, which is considered to be in part reflective of customary international law, holds that ‘unless a different intention appears from the treaty or is otherwise established, a treaty is binding upon each party in respect of its entire territory’.⁶² The inclusion of the term ‘entire territory’ is arguably intended to ensure that either States establish that the relevant treaty is limited in application to certain areas or failing the inclusion of an express limitation, apply the treaty throughout their territories.⁶³ Furthermore it is submitted that, as previously mentioned, the ICESCR and ICCPR are considered to be the two legal instruments through which the principles of UDHR are codified thus an extraterritorial interpretation is in keeping with the *raison d’être* of the ICESCR and thus arguably implicit in the application of the rights contained within the Covenant.⁶⁴

Further support for the recognition of the extraterritorial obligations of States may be found in the adoption of the Maastricht Principles. The Maastricht principles were drawn up following a gathering of international experts in international law and human rights. They reflect the culmination of more than a decade’s worth of legal research. Whilst it remains to be seen how the international community, as represented by the UN, responds to

⁶⁰ International Covenant on Civil and Political Rights (adopted 16 December 1966, entered into force 23 March 1976) 999 UNTS 171 (ICCPR) art 2(1) (emphasis added).

⁶¹ International Covenant on Economic, Social and Cultural Rights, (adopted 16 December 1966, entered into force 3 January 1976) 993 UNTS 3 (ICESCR) art 2(1); Malcolm D. Evans, *International Law* (2nd edn, Oxford University Press 2006) 190, citing *Kasikili/Sedudu Island (Botswana/Namibia)*, *Judgment*, *ICJ Reports 1999*, p 1045, para 18.

⁶² Vienna Convention on the Law of Treaties (adopted 23 May 1969, entered into force 27 January 1980) 1155 UNTS 331 (VCLT) art 29.

⁶³ Rolf Künemann, ‘The Extraterritorial Scope of the International Covenant on Economic, Social and Cultural Rights’ (Brot für die Welt/FIAN/EED 1 October 2001) 3 <<http://www.fian.org/resources/documents/others/extraterritorial-state-obligations-international-covenant-on-economic-social-and-cultural-rights/pdf>> accessed 8 August 2012.

⁶⁴ *ibid.*

these principles, it should be noted that the background and basis for the principles have been adopted into the general body of international human rights law, via General Comments.⁶⁵ In spite of the recognition afforded under the ICESCR and the corresponding General Comments, the UN monitoring bodies have left the door open to debate and have not gone so far as to conclude that this principle should extend a State's obligation to monitor corporations operating abroad. However there is precedent, which may be relied upon as establishing the beginning of the foundation for such recognition.⁶⁶

The "Protect, Respect and Remedy" Framework has not taken a side within this debate but has expressly reflected the differing points of view on the application of extraterritorial obligations through the following conclusion:

Experts disagree on whether international law requires home States to help prevent human rights abuses abroad by corporations based within their territory. There is greater consensus that those States are not prohibited from doing so where a recognized basis of jurisdiction exists, and the actions of the home State meet an overall reasonableness test, which includes non-intervention in the internal affairs of other States.⁶⁷ Indeed, there is increasing encouragement at the international level, including from the treaty bodies, for home States to take regulatory action to prevent abuse by their companies overseas.⁶⁸

⁶⁵ That is, the Maastricht Principles are considered to 'complement and build on the Limburg Principles on the Implementation of the International Covenant on Economic, Social and Cultural Rights (1986) and on the Maastricht Guidelines on Violations of Economic, Social and Cultural Rights (1997)'. A cross-comparative analysis of these works and General Comment 3 on "The Nature of States Parties Obligations" demonstrate how these previous works have directly influenced the drafting of the General Comment and its proposed interpretation of the obligations. Maastricht Principles on Extraterritorial Obligations of States in the area of Economic, Social and Cultural Rights (adopted 28 September 2011) Preamble; David P. Forsythe, *Encyclopedia of Human Rights* (Volume 1, OUP, 2009) 450-451.

⁶⁶ In 2007, the UN Committee on the Elimination of Racial Discrimination in its concluding observations encouraged Canada to 'take appropriate legislative or administrative measures to prevent acts of transnational corporations registered in Canada negatively impact on the enjoyment of rights of indigenous peoples in territories outside Canada'. UN Committee on the Elimination of Racial Discrimination, 'Consideration of Reports Submitted by State Parties Under Article 9 of the Convention, Concluding observations of the Committee on the Elimination of Racial Discrimination' (25 May 2007) UN Doc CERD/C/CAN/CO/18 para 17.

⁶⁷ The entire human rights regime may be seen to challenge the classical view of non-intervention, but the debate here hinges on what is considered coercive.

⁶⁸ For instance, the Committee on the Elimination of Racial Discrimination recently encouraged a State party to 'take appropriate legislative or administrative measures' to prevent adverse impacts on the rights of indigenous peoples in other countries from the activities of corporations registered in the State party. UN Committee on the Elimination of Racial Discrimination, 'Consideration of Reports Submitted by State Parties Under Article 9 of the Convention, Concluding observations of the Committee on the Elimination of

However in spite of the door being left open for States to individually determine the extent of their obligations to companies operating overseas, ‘some States hold that this duty is limited to protecting persons who are both within their territory and jurisdiction’.⁶⁹

Regulation Of Banks’ Activities

It is evident that, as the primary duty-bearers, States bear the obligation of establishing the appropriate legislation and regulatory measures to ensure that third parties do not perpetrate human rights abuses. However, as highlighted in the preceding sections, in spite of this recognition afforded to the role of States there is a clear lack of implementation or supervision of the activities of corporations across State borders.⁷⁰ Inter-governmental forums, such as the UN and the Organisation for Economic Co-Operation and Development, reflect this lack of co-ordination between States, as currently only nonbinding guidelines are provided to both States and corporations.⁷¹ In short, there is no international forum in which to hold corporations accountable for human rights abuses.⁷² This lack of regulation

Racial Discrimination’ (25 May 2007) UN Doc CERD/C/CAN/CO/18 para 17; UN HRC ‘Protect, Respect and Remedy: a Framework for Business and Human Rights, Report of the Special Representative of the Secretary-General on the issue of human rights and transnational corporations and other business enterprises, John Ruggie,’ (07 April 2008) A/HRC/8/5 para 19.

⁶⁹ UN HRC, ‘Implementation of General Assembly Resolution 60/251 of 15 March 2006 Entitled “Human Rights Council”: Report of the Special Representative of the Secretary-General on the issue of human rights and transnational corporations and other business enterprises, (Addendum) State responsibilities to regulate and adjudicate corporate activities under the United Nations core human rights treaties: an overview of treaty body commentaries* **’ (13 February 2007) A/HRC/4/35/Add.1 s V; UN HRC, ‘Protect, Respect and Remedy: a Framework for Business and Human Rights, Report of the Special Representative of the Secretary-General on the issue of human rights and transnational corporations and other business enterprises, John Ruggie,’ (07 April 2008) A/HRC/8/5 para 18 and fn 10 (A/HRC/4/35 and A/HRC/4/35/Add.1.); UN HRC, ‘Guiding Principles on Business and Human Rights: Implementing the United Nations “Protect, Respect and Remedy” Framework, Report of the Special Representative of the Secretary-General on the issue of human rights and transnational corporations and other business enterprises, John Ruggie,’ (21 March 2011) A/HRC/17/31 paras I.A.1 and 2.

⁷⁰ Reference is made here to the Basel Committee on Banking Supervision’s failed attempts to allocate ‘responsibility for the supervision of transnational banks, based on the broad principle of home country responsibility for solvency, and that of the host for liquidity’; the noted inadequacies of the Offshore Group of Banking Supervisors; and the lack of success of the International Banking Facility in New York. Sol Picciotto, ‘Disembedding and Regulation: The Paradox of International Finance’ (5 February 2009 – 7 February 2009) Paper for the Conference on the Embeddedness of Transnational Markets 3–6 <<http://eprints.lancs.ac.uk/23551/>> accessed 18 February 2012.

⁷¹ Some examples being the UN “Protect, Respect and Remedy: a Framework for Business and Human Right, the Global Compact and the Organisation for Economic Co-Operation and Development’s Guidelines for Multinational Enterprises.

⁷² Furthermore it is notable that when the United Nations intervened, their finding of civil liability has been limited to the imposition of economic sanctions, such as fines. Brittany T. Cragg, ‘Home Is Where The Halt Is: Mandating Corporate Social Responsibility Through

applies to all corporations, including the financial sector. In spite of divisions being created in various organisations to establish regulations and monitoring of global transactions conducted by financial providers, the supervision of the human rights impacts of the financial sector in particular has, as yet, remained on the back burner.

The work by the SRSG has raised questions on States' practices in relation to the implementation of human rights obligations into national frameworks. In short the Framework highlights that two different forms of domestic policy incoherence are prevalent amongst States. The first term, 'vertical' incoherence, describes a situation where Governments adopt human rights commitments however fail to implement them into their national system. The second, 'horizontal' incoherence, reflects the situation where various State departments, such as those responsible for trade, investment promotion, development and foreign affairs, fail to work with the governmental authority which is responsible for the application of the relevant human rights standards, thereby ensuring that human rights obligations are not met.⁷³

The research undertaken for the establishment of the Framework highlighted that it is the latter approach, 'horizontal' incoherence, which is replicated on the international level.⁷⁴ It is arguable that this specific failure by Governments to establish regulatory measures across departments may be attributable to the economic theory that markets operate better when unrestricted and left to their own devices. This theory, also known as 'free banking', proposes that fewer regulations will result in increased competition within the market, higher levels of productivity, which in turn would make the market more efficient and lower prices.⁷⁵

Within the financial sector, the debate over the sufficiency of regulatory measures is hotly contested.⁷⁶ On the one hand, advocates of 'free banking'

Home State Regulation and Social Disclosure' (2010) 24 Emory Int'l L. Rev. 735, 745 <www.westlawinternational.com> accessed 09 April 2012.

⁷³ Note the examples of state departments are directly adopted from the text. UN HRC 'Protect, Respect and Remedy: a Framework for Business and Human Rights, Report of the Special Representative of the Secretary-General on the issue of human rights and transnational corporations and other business enterprises, John Ruggie,' (07 April 2008) A/HRC/8/5 para 22.

⁷⁴ *ibid* para 22.

⁷⁵ Barbara Casu, Claudia Girardone and Philip Molyneux, *Introduction to Banking* (Pearson Education Limited, 2006) 161.

⁷⁶ It is interesting to note the following article which draws attention to the United States' context: Zachary A. Goldfarb, 'JP Morgan losses reignite clash between Wall Street and Washington' *Washington Post* (Washington D.C, 12 May 2012)

suggest that the sector is currently heavily regulated and propose that limiting Government regulation will incentivise banks to act on their accord to prevent failure.⁷⁷ On the other hand, many have suggested that the complexity of the products and services offered within the financial sector has meant that this sector, in particular, has suffered from deregulation and as such stricter measures should be imposed.⁷⁸

Amongst this background, it is debatable whether the protection of human rights standards, via regulation, receives due attention. The SRSG drew attention to this particular state of affairs and contested the assumption that ‘governments ... are helping business by failing to provide adequate guidance for, or regulation of, the human rights impact of corporate activities’ by highlighting that ‘the less governments do, the more they increase reputational and other risks to business’.⁷⁹ This conclusion is drawn from the analysis of the performance of markets, which do not operate in a regulatory framework. The Framework expressly highlights that:

history teaches us that markets pose the greatest risks - to society and business itself - when their scope and power far exceed the reach of the institutional underpinnings that allow them to function smoothly and ensure their political sustainability.⁸⁰

Indeed, the SRSG’s reports have highlighted the important role that States hold and have provided illustrations of creative approaches that States may adopt in their attempts to influence ‘corporate culture’.⁸¹ Of relevance, to the discussion at hand, is the suggestion that States implement strategies to ‘support and strengthen market pressures upon companies to respect rights’.⁸² Given the nature of the financial sector, that is the deregularisation

<http://www.washingtonpost.com/business/economy/2012/05/11/gIQAAMT3IU_story.htm> accessed 12 May 2012; Michael Imeson, ‘Over-regulation threatens to capsize US financial sector’ *The Banker* (London, 2 April 2012)

<<http://www.thebanker.com/World/Americas/US/Over-regulation-threatens-to-capsize-US-financial-sector>> accessed 12 May 2012.

⁷⁷ Barbara Casu, Claudia Girardone and Philip Molyneux, *Introduction to Banking* (Pearson Education Limited, 2006) 125 – 126, 161.

⁷⁸ Indeed, some experts are of the opinion that the deregularisation of the financial markets in the United States contributed to both the United States financial crisis and international financial crisis. Olufemi O. Amao, ‘The foundation for a global company law for multinational corporations’ (2010) 21(8) *I.C.C.L.R.*, 275-288.

⁷⁹ UN HRC ‘Protect, Respect and Remedy: a Framework for Business and Human Rights, Report of the Special Representative of the Secretary-General on the issue of human rights and transnational corporations and other business enterprises, John Ruggie,’ (07 April 2008) A/HRC/8/5 para 22.

⁸⁰ *ibid* para 2.

⁸¹ This refers to efforts by governments to foster a culture within corporations, which places the respect for human rights as a central aspect of business operations.

⁸² UN HRC ‘Protect, Respect and Remedy: a Framework for Business and Human Rights, Report of the Special Representative of the Secretary-General on the issue of human rights

of the financial markets, imposing compulsory measures such as sustainability reporting would allow stakeholders to assess the rights-related performance of these companies. The Framework points to examples from various States, sub-national authorities and even stock exchanges that are already encouraging such disclosures.⁸³

Alternatively, an argument may be had for a rethinking of the Westphalian construction of a State's obligation to regulate the activities of a corporation.⁸⁴ Whilst the Westphalian construction of State responsibility holds significant weight, it is important to recognise the developments and challenges brought about as a result of increasing economic globalisation. At the international level, jurisdiction and its corresponding obligations are conferred upon the establishment of a link between a particular State and the commercial activity in question. This jurisdictional link may be derived from the 'physical or legal location, activities, operations, investment solicitations or conduct taking place in the national territory'.⁸⁵ However these links are increasingly becoming harder to determine in situations where such commercial activity takes place within various countries. Furthermore States have demonstrated unwillingness to extend regulatory authority to international bodies such as the World Trade Organisation and International Monetary Fund.⁸⁶ This lacuna has, in effect, resulted in transnational companies self-regulating their international operations. In turn, it has been observed that some 'powerful global firms use their leverage over home State regulation, and over the multilateral institutions which their home States dominate, to create rules which eliminate legal risks to their activities'.⁸⁷ Thus regulation at the international level is required as States are incapable of individually monitoring the extraterritorial human rights impacts that commercial actors have.⁸⁸

and transnational corporations and other business enterprises, John Ruggie,' (07 April 2008) A/HRC/8/5 para 30.

⁸³ *ibid* para 30.

⁸⁴ The Westphalian approach refers to the notion that state sovereignty and its corresponding regulation requirements arise from the construction of territoriality.

⁸⁵ Pierre Schammo, 'Regulating Transatlantic Stock Exchanges (October 2008) vol 57 ICLQ 827–862, 838.

⁸⁶ Frank J. Garcia, 'The Moral Hazard Problem in Global Economic Regulation' (2008) Boston College Law School Faculty Papers Paper 227, 3

<<http://lawdigitalcommons.bc.edu/lfsp/227>> accessed 14 April 2012.

⁸⁷ *ibid*.

⁸⁸ *ibid* 2.

2.2.2 Pillar II: The Corporate Responsibility To Respect Human Rights

In general the underlying principle of Pillar II may be interpreted as conveying a negative obligation upon corporations. That is to say that whilst businesses are not expected ‘to solve all the world’s problems ... [they] are not expected to make them worse’.⁸⁹ It should be noted that the Pillar requires that companies undertake a ‘due diligence’ process in order to identify, prevent, mitigate, and account for human rights impacts.⁹⁰ The scope and extent of this process and the obligations arising under it varies according to numerous factors, such as size, sector, operational context, ownership, and structure.⁹¹

Understanding The Nature Of The Responsibilities

It is submitted that the SMSG has chosen not to ‘frame the relationship between investors and the companies they invest in as one of complicity ... [and that these] responsibilities are not discussed in the same breath with value chain responsibility either’ and that the responsibility of companies within the sector stem from corporate governance structures and an assumption of responsibility as an active shareholder or ownership.⁹² However it is the author’s proposition that this conclusion is dependent on the rights conferred through the financing relationship and cannot be seen as applying across-the-board to all financing relationships. Thus it is submitted that a thorough analysis of the financing provided must be undertaken prior to the determination of ‘active shareholder or ownership’.

As previously mentioned, the provision of finance via equity financing relationships entails a company issuing stocks in their company as a means of raising funds. In short, equity financing raises the question whether banks, as a result of their financing relationships based in equity, are in effect part of the company and therefore partly responsible for the decisions

⁸⁹ John Ruggie, ‘Engaging Export Credit Agencies in Respecting Human Rights’ (OECD Export Credit Group’s “Common Approaches” Meeting, Paris, 23 June 2010) 5.

⁹⁰ UN HRC ‘Guiding Principles on Business and Human Rights: Implementing the United Nations “Protect, Respect and Remedy” Framework, Report of the Special Representative of the Secretary-General on the issue of human rights and transnational corporations and other business enterprises, John Ruggie,’ (21 March 2011) A/HRC/17/31 para II.A.14.

⁹¹ UN HRC ‘Guiding Principles on Business and Human Rights: Implementing the United Nations “Protect, Respect and Remedy” Framework, Report of the Special Representative of the Secretary-General on the issue of human rights and transnational corporations and other business enterprises, John Ruggie,’ (21 March 2011) A/HRC/17/31 para II.A.15; John Ruggie, ‘Engaging Export Credit Agencies in Respecting Human Rights’ (OECD Export Credit Group’s “Common Approaches” Meeting, Paris, 23 June 2010) 5.

⁹² Radu Mares, ‘Business and Human Rights After Ruggie: Foundations, the Art of Simplification and the Imperative of Cumulative Progress’ in Radu Mares (ed), *The UN Guiding Principles on Business and Human Rights: Foundations and Implementation* (Martinus Nijhoff, 2012) 38–40.

and actions taken? Or alternatively, are they an extension of the value chain, that is to say an additional tier that is representative of the apex of the value chain and thereby merely complicit in the company's actions? The answer to this conundrum lays in the assessment of the nature of the rights bestowed to the bank, as a shareholder in the client's operations, and to clients, as a shareholder in the bank's operations.

First and foremost, one must consider whether the shareholder in question holds a minority or majority stake within the private entity. Further an enquiry must be made into the nature of the stake, that is if participatory rights are granted and if these rights confer positive or negative control.⁹³

From this perspective, four distinct scenarios emerge. They are as follows:

- I. Both the bank and client exercises a degree of control over each other's management structure, on account of each entity holding shares that confer participatory rights in the other;
- II. The bank owns shares that confer participatory rights in the client's operations, which allows for them to exercise a degree of control in the client's operations however the client does not own such shares;
- III. Neither the bank nor the client own stock which allows for them to exercise a degree of control over each other's management structure; or
- IV. The client owns shares that confer participatory rights in the bank's operations, which grants a degree of control over the bank's operations however the bank does not.

Within the first scenario, the conclusion is clear-cut. It is evident that the bank and the client should be considered to be one and the same, in respect to ownership and control, and thus one is not required to enter into a discussion regarding value chain and notions of complicity. The same analysis may be applied to the second scenario, as from the circumstances it is evident that the foundation of active ownership is established and the bank is able to exercise control over the client. However the third scenario provides a set of circumstances where the bank and client are not owned or controlled by the other party. As a consequence, clear grounds are established for the extension of the value chain and the consideration of complicity. The fourth scenario is unique, in that it gives rise to a potential conflict of interest. That is to say, that whilst the bank does not own shares, which grant control over the client's management, the client does. Therefore the extension of the value chain is established and discussions regarding the

⁹³ Participatory rights are linked to whether the stockholder is given voting rights. Positive or negative control raises the question whether the shares confer the ability to block the passing of a resolution. Eg a resolution related to the consideration of extra-financial information in financial risk analysis.

bank's complicity in labour rights violations by the client may be compromised by the client's influence on the bank's management board.

Alternatively, when one considers the nature of the financial sector, one should consider whether commercial banks, are implicated in labour rights violations as a consequence of their connection to the perpetrators of labour rights violations. The essential feature of debt financing demonstrates that commercial banks do not own a portion of the company but rather are providing financing capital to companies through other products, such as bonds, corporate loans and revolving credit facilities. Thus it is the author's submission that an argument may be had for the establishment of the corporate complicity of private enterprises. Whilst there is no definitive test for the finding of corporate complicity,⁹⁴ it is sufficient to note that the concept 'refers to indirect involvement by companies in human rights abuses - where the actual harm is committed by another party, including governments and non-State actors'.⁹⁵ And moreover that the Framework establishes the requirement that all businesses:

- (a) Avoid causing or contributing to adverse human rights impacts through their own activities, and address such impacts when they occur; and
- (b) Seek to prevent or mitigate adverse human rights impacts that are directly linked to their operations, products or services by their *business relationships*, even if they have not contributed to those impacts.⁹⁶

Thus the Framework establishes that commercial banks are not exempt by the mere fact that they have not directly contributed to the labour rights violation through their conduct. As they bear a responsibility on account of their business relationship, which is defined as including 'relationships with business partners, entities in its value chain, and any other non-State or State entity directly linked to its business operations, products or services'.⁹⁷

⁹⁴ UN HRC 'Protect, Respect and Remedy: a Framework for Business and Human Rights, Report of the Special Representative of the Secretary-General on the issue of human rights and transnational corporations and other business enterprises, John Ruggie,' (07 April 2008) A/HRC/8/5 para 76-80.

⁹⁵ *ibid* para 73.

⁹⁶ UN HRC 'Guiding Principles on Business and Human Rights: Implementing the United Nations "Protect, Respect and Remedy" Framework, Report of the Special Representative of the Secretary-General on the issue of human rights and transnational corporations and other business enterprises, John Ruggie,' (21 March 2011) A/HRC/17/31 para. II.A.13 (emphasis added).

⁹⁷ *ibid* Commentary on para. II.A.13.

Addressing The Fiduciary Duty Of Financial Managers

There are a numerous techniques used to assess the profitability of prospective investments. The net present value rule,⁹⁸ internal rate of return investment rule⁹⁹ and payback investment rule¹⁰⁰ are a few examples of the various tools that financial managers at commercial banks utilise. Regardless of the technique adopted, the investment decisions of the financial managers are constrained by two general obligations, which apply to all companies. The first being the duty of care and the second being that of loyalty. For the purposes of the thesis, particular focus will be given to the interpretation of these duties as they relate to a financial manager's fiduciary duty to their clients.

As noted in the introduction, CSR issues do not relate to questions of corporate philanthropy but rather to the incorporation of labour rights concerns within the operations of the company, that is the commercial bank, in question. The discussion within the thesis and the CSR debate centres on the inclusion of extra-financial information, such as a client's observance of labour rights, in a commercial bank's decision-making process. Thus the issue that will be addressed under this section is the concern, which many managers may have, that the inclusion of extra-financial information (such as the labour rights practices of the potential clients) may be construed as a moral hazard,¹⁰¹ if it cannot be justified as contributing to increasing the profits or value of the company.¹⁰²

The fiduciary duty of managers is mainly concerned with increasing the value of the company and guarding against issues of self-motivated profit making and conflict. Previously the question of whether the adoption of a risk assessment approach, which paid attention to certain E&S concerns, conflicted with the fiduciary duty of managers generated significant debate. With some managers refusing to incorporate E&S issues into their

⁹⁸ The project's net present value is compared the net present value of doing nothing (i.e. zero) and the project is accepted is the net present value is a positive value. Jonathan Berk, Peter DeMarzo and Jarrad Harford, *Fundamentals of Corporate Finance* (2nd edn, Pearson Education Limited, 2012) 157–159.

⁹⁹ Investment opportunities are accepted if the internal rate of return exceeds the opportunity cost of capital contributed. *ibid* 160–164.

¹⁰⁰ The project is accepted if the cash flows from the project pay back the initial investment within a pre-specified time period. *ibid* 164–166.

¹⁰¹ A “moral hazard” arises when a contract or financial arrangement creates incentives for parties to behave against the interest of others. Examples being re-appropriating funds invested for one project to another not originally agreed upon. This potentially represents a conflict of the fiduciary duty to act in the best interests of the bank and its shareholders. Barbara Casu, Claudia Girardone and Philip Molyneux, *Introduction to Banking* (Pearson Education Limited, 2006) 11.

¹⁰² Marcel Jeucken, *Sustainable Finance & Banking: The Financial Sector and the Future of the Planet*, (Earthscan Publications Ltd, 2001) 67–68.

assessments.¹⁰³ However the integration of E&S issues into an investment process, which focuses on improving risk-adjusted returns has now come to be accepted as consistent with the fiduciary duty.¹⁰⁴ However that being said, it should be noted that risk assessment processes, which focus solely on E&S concerns, to the detriment of increasing the value of the company¹⁰⁵ might be construed as a breach of the duty of loyalty.¹⁰⁶

Alternatively another approach to this issue that may be adopted rests on the debate that financial managers should redefine the scope of stakeholders. In short the proposition holds that shareholders are not the only interest group, which should factor into the investment decision making process. This debate relies upon the stakeholder theory, mentioned in Chapter One and holds that the financial manager's duty of care is not limited to the shareholders of the company but rather extends to a wider group of parties, such as employees, society and consumers.¹⁰⁷

2.3 Summary

The Chapter has demonstrated that the UN Framework has provided a much-needed focal point in the discussion of CSR. The matrix provided by the Framework establishes a dual construct of social responsibility, with the primary duty resting on the State and the subsidiary being attributed to corporations. Moreover it provides support and recognition for the applicability of the human rights principles, established by International Bill of Rights and the “core” ILO labour standards, to corporations. In addition the Chapter highlighted that States, corporations and other entities have launched a number of industry-specific initiatives as a response to the increased demand for guidelines and recommendations on the observance of human rights within the business field. However it is of significance that such measures within the financial sector have concentrated on particular financial products¹⁰⁸ and social issues, such as environmental challenges. Nevertheless these guidelines play an important role in providing an

¹⁰³ David Hess, ‘Public Pensions and the Promise of Shareholder Activism for the Next Frontier of Corporate Governance: Sustainable Economic Development’ (2007) 2 Va. L. & Bus. Rev. 221 <www.westlawinternational.com> accessed 16 April 2012.

¹⁰⁴ *ibid.*

¹⁰⁵ In either the short-term of profit generation or the long-term of brand management and value creation.

¹⁰⁶ Examples of such conduct may be when a financial manager concentrates on supplying benefits to third parties or if they misappropriate funds to pursue their own political interests. David Hess, ‘Public Pensions and the Promise of Shareholder Activism for the Next Frontier of Corporate Governance: Sustainable Economic Development’ (2007) 2 Va. L. & Bus. Rev. 22 <www.westlawinternational.com> accessed 16 April 2012.

¹⁰⁷ Caspar Rose, ‘The challenges of employee-appointed board members for corporate governance: the Danish evidence’ (2008) 9(2) E.B.O.R., 215-235, 221–222 <www.westlawinternational.com> accessed 18 April 2012.

¹⁰⁸ Such as project financing and SRI.

understanding of the approach being adopted by commercial banks and highlighting the challenges of mainstreaming labour rights concerns into financing relationships.

Through an analysis of the UN Framework, the Chapter presented particular issues, which face both States and corporations operating in the financial sector. Through a discussion of the challenges arising under Pillar I, it is evident that States have failed to implement a system of monitoring corporations that operate across borders. Within the domestic context, the research conducted by the SRSG has highlighted that Governments are prone to suffer from ‘vertical’ policy incoherence and/or ‘horizontal’ policy incoherence. With the net result being a failure, by the State, to cohesively implement human rights obligations into their domestic framework. Furthermore the replication of ‘horizontal’ policy incoherence on the international level has raised questions by the SRSG whether States are ‘helping or harming’ corporations by leaving the market largely unfettered by regulations. In recognition of the primary role of States and the increasing scope of business activities, support has mounted for States to increase efforts aimed at human rights protection both domestically and outside their territory.

The unique nature of a bank and its products was presented through the discussion on the responsibilities arising under Pillar II. The discussion highlighted that an assessment of the bank-client relationship was a necessary pre-requisite to the determination of the nature of social responsibility. It was demonstrated that the nature of the rights granted through the equity financing form of shares raised a multitude of scenarios. These ranged from a bank being construed as an extension of the value chain of a company and therefore an active owner within the company to the bank holding no control over the company and therefore not directly responsible for its actions. Alternatively it was shown that a bank was not exempt from responsibility where they had only provided debt-financing relationships. In such circumstances, the concept of ‘complicity’ may be seen to attach and a commercial bank may be responsible on account of their connection to the perpetrators of labour rights violations. The Chapter moved on to enquire into the fiduciary duty of financial managers. From the analysis, it was concluded that the incorporation of extra-financial information into financial risk analysis processes is consistent with the fiduciary obligations of managers. However it was highlighted that financial managers are not able to base their decision solely upon a consideration of E&S factors.

3 Challenges Of Mainstreaming Labour Rights Into Financing Relationships

This Chapter will focus on the difficulties, raised by mainstreaming labour rights standards into the financial products provided by commercial banks. Within the financial sector, the integration of E&S factors is seen to consist of two components. The first is the management of E&S risks in decision-making and lending processes and the second is the identification of new opportunities for product development in fields directly related to E&S.¹⁰⁹ The goal of the thesis is to mainstream extra-financial information into the former component. However due regard will be given to the research conducted under the latter component, as the common denominator between the methods is the incorporation of extra-financial information into the investment analysis for SRI products. The Chapter will examine whether the financial products provided in the coal-mining sector contain inherent barriers to the inclusion of labour rights standards. The products highlighted in the study have been divided according to the nature of the financing relationship and will be dealt with under the appropriate heading. The Chapter will conclude by enquiring into the general challenges of incorporating extra-financial information into the financial sector.

3.1 Methods Of Labour Rights Integration

There is admittedly no standard approach to implementing human rights issues, such as labour rights, into financing decisions. However whilst the financial sector is embracing different approaches, it is evident that techniques of risk assessment and mitigation are far from mainstreamed into commercial financing practices and instead are only offered by specific institutions, or by defined departments within institutions, which focus specifically on SRI.¹¹⁰

¹⁰⁹ IFC, 'Banking on Sustainability' (IFC, January 2007) 8 <www1.ifc.org> accessed 7-10 March 2012.

¹¹⁰ This niche market highlights three distinct techniques regarding the incorporation of labour rights concerns. These three consist of: 1) negative screening; 2) divestment; and 3) positive investment. Negative screening excludes financing relationships of companies that do not comply with ESG requirements. Divestment entails the removal of financing relationships from one's portfolio on the basis that they fail to meet the previously mentioned requirements. Alternatively positive investing is the act of investing in financing relationships with companies that apply ESG throughout their operations and activities. Positive investing has been aided by the introduction of SRI indices, such as the Dow Jones Sustainability Indexes and FTSE4Good Index Series, to track the practices and performance of companies that apply corporate responsibility standards.

It is clear that the core component of approaches to E&S integration within the financial sector build off the inclusion of extra-financial information. Extra-financial information relates to concerns covered under the broad spectrum of E&S; thereby labour rights issues are incorporated under this umbrella term.¹¹¹ The term, E&S, specifically refers to the emergence of a global recognition that investors consider E&S issues within the context of corporate behaviour.¹¹² To date, there is no exhaustive list of E&S issues though it is commonplace for such issues to display one or more of the following characteristics:

- Traditionally considered to be “non-financial” and therefore not material to investment decisions;
- Concerned with objectives that have a medium or long-term scope/timeframe;
- Qualitative nature, which is not easily quantifiable in monetary terms;
- Externalities that are not well captured by current market mechanisms;
- Reflect a changing regulatory or policy framework;
- Arising on account of the company’s value chain¹¹³ and thus susceptible to unknown risks;
- Focus on an issue of defined as being of public-concern.¹¹⁴

¹¹¹ Thus the author will use the two terms, E&S and labour rights, interchangeably.

¹¹² Aaron Bernstein, ‘Incorporating Labor and Human Rights Risk into Investment Decisions’ (September 2008) Pensions and Capital Stewardship Project: Labor Worklife Program, Harvard Law School

<www.law.harvard.edu/programs/lwp/pensions/publications/occpapers/occasional_paper2.pdf> accessed 20 February 2012; United Nations Environment Programme Finance Initiative (UNEP FI) and World Business Council for Sustainable Development (WBCSD), ‘Translating environmental, social and governance factors into sustainable business value; key insights for companies and investors’ (March 2010) Report from International Workshop Series of the WBCSD and UNEP FI, 6
<www.unepfi.org/fileadmin/documents/translatingESG.pdf> accessed 18 April 2012.

¹¹³ ‘This concept divides a company’s activities into the technologically and economically distinct activities it performs to do business. We call these “value activities” ... Primary activities are those involved in the physical creation of the product, its market and delivery to buyers, and its support and servicing after sale. Support activities provide the inputs and infrastructure that allow the primary activities to take place’. Michael E. Porter and Victor E. Millar, ‘How Information Gives You Competitive Advantage’ (July-August 1985) 3 Harvard Business Review <<http://www.mendeley.com>> accessed 15 April 2012.

¹¹⁴ UNEP FI and WBCSD, ‘Translating environmental, social and governance factors into sustainable business value; key insights for companies and investors’ (March 2010) Report from International Workshop Series of the WBCSD and UNEP FI, 6
<www.unepfi.org/fileadmin/documents/translatingESG.pdf> accessed 18 April 2012.

3.2 The Challenges Posed By The Financial Products Provided

As previously noted, commercial banking entities offer companies various forms of external finance, which give rise to different considerations.¹¹⁵ For example, the terms and agreements governing debt-financing instruments such as corporate loans and revolving credit facilities are considered to be more opaque than that of bonds or equity-financing instruments, such as shares.¹¹⁶ The purpose of this section is to examine whether there are any inherent challenges in the financial products provided within the coal-mining sector that prevent the inclusion of E&S issues. In doing so the author will consider the nature and construction of the products and where possible, suggest ways that commercial banks may mainstream labour rights considerations into the products offered.

3.2.1 Debt Financing

Financial institutions regularly consider extra-financial information, such as the ‘qualitative attributes of the firm and the entrepreneurs as proxies for the viability of the project and the firm’¹¹⁷ prior to issuing debt-financing instruments, such as corporate loans and revolving credit facilities. Moreover many financial entities provide direction to firms through assistance in the design of projects and methods of implementation.¹¹⁸ The major issue occurs when such financing is not tied to a clear project or purpose. In short, unlike for example project finance, general forms of financing are not clearly tied to specific company activities but are granted to the company to distribute as they see fit within their operations. As a consequence a bank is unable to trace the flow of money and ensure that the funds provided by them have not been used in operations that infringe labour rights.

Bonds

Bonds, in essence, are tradable certificates of debt. Both public and private entities are able to issue these certificates in their efforts to raise money. The certificates create an obligation on the part of the issuer to repay the holder the sum borrowed (“face value”) plus any interest payments (“coupons”) agreed upon. There are a variety of bonds that serve different purposes.¹¹⁹

¹¹⁵ A previous example given was in respect to the nature of the responsibility from the form of financing relationship.

¹¹⁶ Bert Sholtens, ‘CSR in the International Banking Industry’ (2009) 86 *Journal of Business Ethics* 159–175.

¹¹⁷ *ibid.*

¹¹⁸ *ibid.*

¹¹⁹ Eg municipal bonds are issued by public entities that aim to raise money for infrastructure and development of public services; high-yield bonds are issued by private

However in general, the face value of the bond must be met by a particular date and prior to that date the holder will receive regular payments at the coupon rate.¹²⁰

The contract provisions of a bond are known as covenants. Generally covenants are used to establish clauses, which would discourage issuers from taking actions that would jeopardise their ability to repay the face value and coupons.¹²¹ From the outset it is clear that in addition to the clauses that limit the issuer's actions in relation to the repayment of the bond, one is able to insert provisions regarding their observance of labour rights. However whilst the inclusion of such extra-financial information does not present a problem where the bank is the bondholder, the same cannot be said for circumstances where the bank is the issuer. It is evident that if the bank is an issuer then the ability to impose provisions relating to the observance of labour rights rests with the company and the bank is unable to impose such requirements on the bond.

Corporate Loans

A corporate loan is extended to a business to cover expenses arising from the company's operations and activities.¹²² A standard loan agreement establishes a single, end-of-period-payment loan, whereby the borrower must pay back the principal sum and interest due in one lump payment.¹²³ The contractual terms of the loan establish whether the interest rate is fixed or variable. In addition the terms of the contract may provide a means through which a commercial bank is able to integrate labour rights protections.

Revolving Credit Facilities

A credit facility is another bank loan arrangement under which a bank allows a company to borrow any sum they require, up to a fixed amount.¹²⁴

entities that do not satisfy the 'investment-grade' ratings of credit rating organisations, like the Standard & Poor's Rating Services. As their rate of default is high, these issuers agree to pay a higher interest rate in order to compensate for the additional risk that holders will bear; callable bonds are issued by public entities and allows them the right to redeem the bond at a predetermined price at established times prior to the bond's maturity; and zero-coupon bonds which are sold at a discount of the face value in order to make up for the fact that no coupons will be distributed.

¹²⁰ The Financial Times Ltd, 'Financial Times Lexicon'

<<http://lexicon.ft.com/Term?term=bond>> accessed 15 March 2012.

¹²¹ Jonathan Berk, Peter DeMarzo and Jarrad Harford, *Fundamentals of Corporate Finance* (2nd edn, Pearson Education Limited, 2012) 445 – 452.

¹²² The Financial Times Ltd, 'Financial Times Lexicon'

<<http://lexicon.ft.com/Term?term=corporate-loan>> accessed 15 March 2012

¹²³ Jonathan Berk, Peter DeMarzo and Jarrad Harford, *Fundamentals of Corporate Finance* (2nd edn, Pearson Education Limited, 2012) 601.

¹²⁴ *ibid.*

These arrangements may be either uncommitted or committed. An uncommitted credit facility is an informal agreement under which the bank is not legally obligated to provide funds. In contrast, a committed credit facility is a legally binding contract, which obliges the bank to supply the firm with funds, provided that the company satisfies the requirements established in the agreements.¹²⁵ A revolving credit facility constitutes an example of the latter form of credit facility and is automatically renewed once the whole sum (or an agreed upon portion) has been repaid.¹²⁶ As a committed credit facility, a bank is able to impose provisions regarding the observance of labour rights within the contract.

3.2.2 Equity Financing

Share Holdings

A share¹²⁷ represents ‘a unit of ownership of a company, entitling the holder to receive dividends and normally to vote on important corporate matters’.¹²⁸ There are two main categorisations of shares: common shares and preferred shares.¹²⁹ A common share constitutes a share of ownership in the corporations that grants its owner rights to any common dividends as well as rights to vote on the election of directors, mergers, and other major events. Preferred shares are shares, which have preference over common shares in the distribution of dividends or cash during liquidation. In general, preferred shares do not confer the same voting rights as common shares. In addition to these main categories, a company is able to customise different classes of shares in order to meet various requirements. The standard goal is to raise financing and retain voting rights amongst a select group within the company. A commercial entity is able to accomplish this through the issuance of non-voting shares.¹³⁰ It should be noted that this latter form of shares establishes a clear barrier to the integration of labour rights as it prevents shareholders from expressly voicing their perspective on the role of extra-financial information within the financing process. However in addition to exercising voting rights, a shareholder is able to avail themselves of alternative measures, which they may use to influence the direction of the company. Such measures include engaging management in a dialogue on

¹²⁵ *ibid.*

¹²⁶ The Financial Times Ltd, ‘Financial Times Lexicon’ <<http://lexicon.ft.com/Term?term=revolving-credit>> accessed 15 March 2012; Jonathan Berk, Peter DeMarzo and Jarrad Harford, *Fundamentals of Corporate Finance* (2nd edn, Pearson Education Limited, 2012) 602.

¹²⁷ Also known as stock.

¹²⁸ The Financial Times Ltd, ‘Financial Times Lexicon’ <lexicon.ft.com/Term?term=share> accessed 15 March 2012.

¹²⁹ Jonathan Berk, Peter DeMarzo and Jarrad Harford, *Fundamentals of Corporate Finance* (2nd edn, Pearson Education Limited, 2012) 185–187.

¹³⁰ The Financial Times Ltd, ‘Financial Times Lexicon’ <lexicon.ft.com/Term?term=non_voting-shares> accessed 15 March 2012.

corporate policies or alternatively filing a resolution with management on an issue, such as the incorporation of extra-financial information.¹³¹

Further one should take into account that many of the financing relationships, highlighted in the study on coal mining, involved more than one bank. The issue, which arises in this respect, is whether shareholders can be seen to exercise effective control over the direction that the commercial entity pursues. It is not feasible to consider that a shareholder would hold interests in all of the banks involved in a financing relationship. However it may be possible to consider the possibility of shareholder activism.¹³² That is when a group of like-minded shareholders, holding interests in the banks involved, exercise their voting power to promote the incorporation of human rights concerns within the bank's financial analysis methods.

3.3 The Challenges Of Integrating Labour Rights Into The Financial Sector

The above analysis highlights that there are no significant challenges to be noted in respect to attempting to integrate E&S issues, such as labour rights concerns, into the financial products. Thus the thesis will turn to consider the challenges, which arise from attempting to implement E&S issues into the financial sector. It is the author's perspective that within the financial sector, the major barrier, which impedes the mainstreaming of labour rights issues into investment decisions, is the establishment of a "business case" for the inclusion of E&S concerns. The following section will elaborate on the challenges involved in establishing a compelling "business case" for the mainstreaming of labour rights.

3.3.1 Developing The "Business Case" For Mainstreaming Environmental And Social Issues

As mentioned above, financing entities have been known to take into account extra-financial information in their assessment of the viability of a financing relationship. However this approach is at the bank's discretion and is largely dependent on their understanding of the value of such information. It is submitted that the lack of comprehension regarding the contribution of extra-financial information stems from four interlinking factors:

- 1) The construction of the bank's objectives and the corresponding "business case" model to be used;

¹³¹ Bert Sholtens, 'CSR in the International Banking Industry' (2009) 86 *Journal of Business Ethics* 159–175.

¹³² *ibid.*

- 2) The weight to be afforded to extra-financial information;
- 3) Traditional corporate culture; and
- 4) The need for disclosure.

All of which, are seen to nest under the broad challenge that is the development of a “business case”.

Constructing A Model

Two distinct perspectives are proposed in respect to the construction of a “business case”: the first being a general model, which would apply to all actors across all sectors. The second being the IFC’s conclusion that the “business case” for the integration of E&S concerns is a unique construct which requires a ‘dynamic business case’ to be devised from the perspective of the company in question.¹³³ Both constructs reflect an increase in the understanding of the role of reputation and branding.¹³⁴ However the model adopted is dependent on a company’s sector and their objectives. For example, a general model seeks to establish the contribution of E&S to a company in general. In comparison, a specific context requires a company to take into account their individual circumstances and to define their objectives and strategy accordingly.

As the thesis’ goal is to enquire into mainstreaming E&S issues into relationships, it is submitted that the ‘dynamic business case’ model should be adopted. However the construction of the model must then take into account a commercial bank’s unique position as both a lender/investor and as a borrower/investment opportunity.¹³⁵ These differing roles give rise to two distinct objectives in respect to the construction of a “business model” on the mainstreaming of E&S into financing relationships. Consider that when the bank acts as lender/investor, their main concern is whether their client/investment opportunity will not default on their obligations and will yield a profitable return. On the other hand, when a bank acts as a borrower/investment opportunity, their concern is whether they, themselves, will prove to be creditworthy and will also attract clients/investors. Thus in order to establish a “business case” for mainstreaming, a bank must explore the general benefits of lending/investing in a company that takes into

¹³³ IFC, ‘Banking on Sustainability’ (IFC, January 2007) 14-15 <www1.ifc.org> accessed 7-10 March 2012.

¹³⁴ Whilst compliance with regulations is not a factor to take into consideration, however it is not considered the “top driver” motivating financial institutions to act. *ibid*.

¹³⁵ Keep in mind that when a bank provides corporate loans, revolving credit facilities, are bondholders and/or shareholders that they assume the role of lender/investor, respectively and are thus acting in the traditional sense of a bank. Alternatively as bond issuers and/or share issuers they adopt the role of borrower/investment opportunity, respectively and are thus considered to be a company.

account E&S issues, as well as consider the specific reputational and brand benefits that they would receive from such practices.

Understanding The Value Of Environmental And Social Integration

The contribution of E&S integration to the financial performance of a company is primarily understood to be through market value.¹³⁶ Market value is affected by a number of determinants.¹³⁷ However of interest, is the relationship between market value and notions of brand value and accounting value.¹³⁸ Brand value is understood as ‘the long-term, beyond current discount 5-year earnings, element of market value’ and accounting value is considered to be the ‘asset value of companies’.¹³⁹ The accounting convention holds that both tangible and intangible assets may be taken into account when calculating a firm’s assets.¹⁴⁰ The increased understanding of the importance of a company’s brand has meant that it has come to be classed as an intangible asset, which may be taken into consideration.¹⁴¹ The IFC holds that the value and importance afforded to branding is a subjective exercise, which must be undertaken by the company in question and in turn calculated into their accounts.¹⁴² This conclusion was drawn from the fact that business goals and objectives differ between commercial entities and as such business strategies and the prioritisation of measures will vary.¹⁴³

In addition to any potential effects on a company’s financial performance, the integration of E&S issues may positively impact the company’s

¹³⁶ Market value is considered to be the present value of the commodity/company. Also known as market price. Richard A. Brealey, Stewart C. Myers, Alan J. Marcus, *Fundamentals of Corporate Finance* (6th edn, McGraw-Hill Irwin, 2009) 222 – 227; IFC, ‘Banking on Sustainability’ (IFC, January 2007) 11 <www1.ifc.org> accessed 7-10 March 2012; The European Alliance for CSR, ‘Valuing non-financial performance: Principles’ <<http://investorvalue.org/marketValue.htm>> accessed 15 May 2012.

¹³⁷ Eg the documentation system for business procedures and systems; opportunities for growth; sales; and whether competitors face barriers to entry.

¹³⁸ The European Alliance for CSR, ‘Valuing non-financial performance: Principles’ <<http://investorvalue.org/marketValue.htm>> accessed 15 May 2012.

¹³⁹ *ibid.*

¹⁴⁰ Examples of intangible assets include a company’s goodwill, intellectual property rights (trademarks, patents etc). Richard A. Brealey, Stewart C. Myers, Alan J. Marcus, *Fundamentals of Corporate Finance* (6th edn, McGraw-Hill Irwin, 2009) 67–68; The European Alliance for CSR, ‘Valuing non-financial performance: Principles’ <<http://investorvalue.org/marketValue.htm>> accessed 15 May 2012.

¹⁴¹ Jonathan Berk, Peter DeMarzo and Jarrad Harford, *Fundamentals of Corporate Finance* (2nd edn, Pearson Education Limited, 2012) 46; IFC, ‘Banking on Sustainability’ (IFC, January 2007) 11 <www1.ifc.org> accessed 7-10 March 2012.

¹⁴² IFC, ‘Banking on Sustainability’ (IFC, January 2007) 11 <www1.ifc.org> accessed 7-10 March 2012; The European Alliance for CSR, ‘Valuing non-financial performance: Principles’ <<http://investorvalue.org/financialDrivers.htm>> accessed 15 May 2012.

¹⁴³ IFC, ‘Banking on Sustainability’ (IFC, January 2007) 6 <www1.ifc.org> accessed 7-10 March 2012.

reputation. Studies have demonstrated that an additional driver behind the development of a “business case” is the increase in the understanding of the role of reputation.¹⁴⁴ Research in the financial sector has shown that ‘most individual investors don’t rely on financial statement much at all’ when calculating quality and risk management.¹⁴⁵ Thus these findings highlight the role that a company’s reputation, in respect to their reliability and creditworthiness, plays in risk assessment. Furthermore there is considerable support for the proposition that the consistent observance of E&S issues will translate to risk reduction thereby ‘reduc[ing] the potential for disasters’.¹⁴⁶ It is submitted that if this concept of risk reduction is understood to be of value to investors then it will result in favourable pricing behaviours and associated risk premium of shares.¹⁴⁷

In spite of a variety of academic sources and research studies elaborating on the positive link between the contribution of extra-financial criteria and the favourable financial performance and reputation of a company.¹⁴⁸ It is submitted that there is insufficient research demonstrating a convincing connection between the inclusion of extra-financial information in financing risk analysis and profitable returns.¹⁴⁹ Furthermore there is an equal body of

¹⁴⁴ An additional driver is brand value and compliance with regulations. However compliance with regulations is not considered the “top driver” motivating financial institutions to act. IFC, ‘Banking on Sustainability’ (IFC, January 2007) 6 <www1.ifc.org> accessed 7-10 March 2012.

¹⁴⁵ Jonathan Berk, Peter DeMarzo and Jarrad Harford, *Fundamentals of Corporate Finance* (2nd edn, Pearson Education Limited, 2012) 46.

¹⁴⁶ Malcolm F Arnold, ‘Non-Financial Performance Metrics for Corporate Responsibility Revisited’ (21 September 2009) Paper for European Academy for Business in Society 12 <<http://investorvalue.org/valuingBusiness.htm>> accessed 16 May 2012.

¹⁴⁷ Malcolm F Arnold, ‘Non-Financial Performance Metrics for Corporate Responsibility Revisited’ (21 September 2009) Paper for European Academy for Business in Society Colloquium 12 <<http://investorvalue.org/valuingBusiness.htm>> accessed 16 May 2012; Business in the Community, ‘The Value of Corporate Governance: The positive return of responsible business’ (21 September 2009) Paper for European Academy for Business in Society Colloquium 2-4 <<http://investorvalue.org/valuingBusiness.htm>> accessed 16 May 2012.

¹⁴⁸ Based on conclusions drawn from the following reports. UNEP FI, ‘Demystifying Responsible Investment Performance: A review of Key Academic and Broker Research on ESG Factors’ (UNEP FI and Mercer, October 2007) <<http://www.unepfi.org/publications/investment/>> accessed 10 April 2012; Enhanced Analytics Initiative, ‘Research centre stage: Four Years of the Enhanced Analytics Initiative’ (onValues, 2008) <<http://www.unpri.org/research/>> accessed 03 May 2012; Business in the Community, ‘The Value of Corporate Governance: The positive return of responsible business’ (21 September 2009) Paper for European Academy for Business in Society Colloquium 2-4 <<http://investorvalue.org/valuingBusiness.htm>> accessed 16 May 2012.

¹⁴⁹ This may be attributed to recent empirical studies on the financial performance of socially responsible funds. Analyses provided by such studies have demonstrated that there is no significant difference between returns on socially responsible and conventional funds. Furthermore the financial risks involved in both funds are considered to be of the same level. Thus presenting the argument that SRI investors do not endure a shortage of opportunities and alternatively establishing little financial incentive for managers to apply

evidence, which contests a relationship between risk and the inclusion of E&S issues.¹⁵⁰ Thus the value of labour rights integration on the performance of an investment is, to date, undetermined.¹⁵¹ This noted insufficiency of research is reasonably remedied through the generation of further research into the effects of E&S integration on financial performance and the viability of the risk reduction argument. Some researchers have suggested that at least ten years of consolidated research and corresponding monitoring is needed to validate the assertion that ‘ESG criteria are good proxies for how a company is managed overall and therefore will help forecast how the company will perform in the long term’ and to establish which E&S factors are relevant to increasing the financial performance of a company and standing in respect to their creditworthiness.¹⁵²

Bearing in mind the differing objectives that arise from a bank’s dual role, it is submitted that a bank needs to understand the impact of E&S integration through two approaches. The research clearly supports the need for banks to not only understand the contribution that E&S integration has, in general, to the financial performance and creditworthiness of any potential client/investment opportunity but also to develop their own individual

extra-financial information to their analysis and screening of investments. Bert Sholtens, ‘CSR in the International Banking Industry’, (2009) 86 *Journal of Business Ethics* 159–75.

¹⁵⁰ A study undertaken in 1996 argued that there was inadequate evidence that demonstrated a conclusive connection between risk reduction and observance of E&S issues. Moses L. Pava and Joshua Kruasz, ‘The Association Between Corporate Social-Responsibility and Financial Performance: The Paradox of Social Cost’ (1996) 15-3 *Journal of Business Ethics* 346-348 <<http://www.springerlink.com>> accessed 16 May 2012; Malcolm F Arnold, ‘Non-Financial Performance Metrics for Corporate Responsibility Revisited’ (21 September 2009) Paper for European Academy for Business in Society Colloquium 12 <<http://investorvalue.org/valuingBusiness.htm>> accessed 16 May 2012.

¹⁵¹ UNEP FI and WBCSD, ‘Translating environmental, social and governance factors into sustainable business value; key insights for companies and investors’ (March 2010) Report from International Workshop Series of the WBCSD and UNEP FI 7-11 <www.unepfi.org/fileadmin/documents/translatingESG.pdf> accessed 18 April 2012; Rachel Alembakis ‘Using ESG Factors to Broaden Fixed Income Analysis’ (*The Sustainability Report*, October 28 2011) <<http://www.thesustainabilityreport.com.au/using-esg-factors-to-broaden-fixed-income-analysis/1327/>> accessed 18 April 2012; European Academy of Business in Society, ‘Sustainable Value: Corporate Responsibility, Market Valuation and Measuring the Financial and Non-Financial Performance of the Firm’ (September 2009) Research Project 3, 5-8.

¹⁵² Business for Social Responsibility, ‘Environmental, Social and Governance: Moving to Mainstream Investing?’ (Business for Social Responsibility, June 25, 2008) 4 – 5 <http://bsr.org/reports/BSR_ESG_Mainstream_Investing.pdf> accessed 18 March 2012; UNEP FI and WBCSD, ‘Translating environmental, social and governance factors into sustainable business value; key insights for companies and investors’ (March 2010) Report from International Workshop Series of the WBCSD and UNEP FI 11 ff <www.unepfi.org/fileadmin/documents/translatingESG.pdf> accessed 18 April 2012; Bert Sholtens, ‘CSR in the International Banking Industry’ (2009) 86 *Journal of Business Ethics* 59–175.

“business case”.¹⁵³ For as a lender/investor, a bank will be interested in generally understanding what does E&S integration mean. For example, if the prospective client/company seeking financing, relies upon their brand or reputation¹⁵⁴ then how are the benefits of E&S integration factored into the accounting equation and at what calculation? In addition, does a good track record in observing labour rights constitute evidence that the company has a good corporate governance structure and reliable management overseeing operations? Alternatively, the bank must apply the same questions when they are looking into the benefits of mainstreaming E&S considerations into their operations, through risk analysis processes.¹⁵⁵ It is noted that this latter perspective requires banks to make a concerted effort to commit significant resources¹⁵⁶ to analyse the effects that extra-financial information would have on their returns.

Furthermore one must keep in mind that the standalone merits of the impacts of incorporating E&S issues is meaningless unless one considers the impacts of E&S issues alongside other financial indicators.¹⁵⁷ As mentioned, E&S concerns are only one of the many factors that financial managers must take into account when assessing potential investments.¹⁵⁸ Moreover the compilation of data and the analyses of the connections between the data collected are further complicated by the previously mentioned differing methods of E&S integration. The lack of standardisation may be seen as requiring additional efforts to be taken, in order to establish a baseline against which a comparative analysis may be made.¹⁵⁹

¹⁵³ See text to nn 139-143 for further explanation on how the valuation of branding and reputation is a subjective analysis that a bank is responsible for. The European Alliance for CSR, ‘Valuing non-financial performance: Principles’ <<http://investorvalue.org/financialDrivers.htm>> accessed 15 May 2012.

¹⁵⁴ Eg, consider Ben & Jerry’s.

¹⁵⁵ However noted that the questions in this respect, relate to whether the mainstreaming of E&S into risk analysis will attract more investors/shareholders as it will translate to higher returns on their investment in the bank and if the bank’s observance of E&S issues through their financing relationships will indicate to prospective lenders that the bank is both reliable and creditworthy.

¹⁵⁶ If one were to take into account the previous claim then potentially ten years worth of research may be required.

¹⁵⁷ Such as the profits, expenses, assets and liabilities of the company.

¹⁵⁸ See text to nn 137-142, for an explanation of “market value” and its determinants.

¹⁵⁹ Mainstream investors have been known to observe the long-term performance of a company, as measured against a baseline indicator, when assessing whether or not to incorporate E&S concerns into the investment process. Examples of these practices include Standards & Poor ESG India Index (Index) and the GS Sustain Focus List. Both of these institutions compare the results of the stock picks against internationally recognized baselines. Business for Social Responsibility, ‘Environmental, Social and Governance: Moving to Mainstream Investing?’ (Business for Social Responsibility, June 25, 2008) 7–10 <http://bsr.org/reports/BSR_ESG_Mainstream_Investing.pdf> accessed 18 March 2012.

Challenging The Dominant Corporate Culture

The dominant investment culture of disregarding E&S concerns may be derived from a number of sources. In addition to the lack of understanding of the impacts of E&S integration,¹⁶⁰ the current investment culture reflects a disconnect between the priorities of commercial banks and the requirements for the protection of labour rights and creation of a sustainable society.¹⁶¹ That is, that many financial managers are mainly concerned with the short-term goal of maximising profits as opposed to meeting long-term investment goals and increasing value.¹⁶² Evidence of “short-termism” has only been found in select asset classes, such as fixed income investors that are interested in the treasury markets.¹⁶³ In comparison, those interested in corporate bonds whose maturity date is in 20 years, may be interested in the inclusion of extra-financial information, which may affect the rating and coupon payments of the bond. Research within the field has demonstrated that “short-termism” ‘constitutes the main behavioural impediment to the integration of E&S dimension’.¹⁶⁴ However an investment professional counter-argued that an:

excessive focus on quarterly results, scarce attention to value-creation strategies, and failure to probe deeply enough into long-term performance are believed to be leading to a kind of ‘short-termism’ which damages market credibility and depresses today's economic development.¹⁶⁵

¹⁶⁰ ‘To state an obvious, but often overlooked fact – quarterly earnings do not reflect companies’ long-term viability. Identifying the factors that will drive long-term growth – such as personnel, strategy, financial strength and flexibility, internal corporate governance, innovation and customer service – may be more difficult to quantify, but they offer a more accurate and more complete portrait of a company’s future’. William H. Donaldson as quoted in James O’Loughlin and Raj Thamotheram ‘Enhanced Analytics for a New Generation of Investor: How the Investment Industry Can Use Extra-Financial Factors in Investing’ (May 2006, USS: Universities Superannuation Scheme Limited) 9.

¹⁶¹ Stephan Schmidheiny and Federico J.L. Zorraquin, ‘Financing Change: The Financial Community, Eco-efficiency and Sustainable Development’ (MIT Press, 1998).

¹⁶² An example of an incident that resulted from ‘short-termism’ is the Enron scandal. David Hess, ‘Public Pensions and the Promise of Shareholder Activism for the Next Frontier of Corporate Governance: Sustainable Economic Development’ (2007) 2 Va. L. & Bus. Rev. 22 <www.westlawinternational.com> accessed 16 April 2012.

¹⁶³ Business for Social Responsibility, ‘Environmental, Social and Governance: Moving to Mainstream Investing?’ (Business for Social Responsibility, June 25, 2008) 13 <http://bsr.org/reports/BSR_ESG_Mainstream_Investing.pdf> accessed 18 March 2012.

¹⁶⁴ David Bourghelle, Danyelle Guyatt, Hager Jemel and Céline Louche, ‘Changing conventional practices: Integration of extra-financial information into stock valuation and investment decision processes’ (2007) Working Paper for 20th EBEN Annual Conference, Leuven <ead.univ-angers.fr/~granem08/IMG/doc/Bourghelle-2.doc> accessed 18 March 2012.

¹⁶⁵ Dean Krehmeyer, Matthew Orsagh and Kurt N. Schacht, ‘Breaking the Short-Term Cycle: Discussion and Recommendations on How Corporate Leaders, Asset Managers, Investors, and Analysts Can Refocus on Long-Term Value’ (CFA Centre for Financial Market Integrity/ Business Roundtable Institute for Corporate Ethics, 2006) Symposium

However it is superficial to only consider the perspective of financial managers and not that of the clients as they may reflect the roots of the issue. Indeed investors may move to prevent the consideration of extra-financial information. This point supports the previous assertion that there is a pressing demand to provide research demonstrating the positive correlation between corporate social performance and corporate financial performance.¹⁶⁶ Albeit some have argued that corporate management should adhere to the minimum legal requirements and not take into account investors who are open to the inclusion of E&S issues.¹⁶⁷ The submission holds that corporate management would be entering into inappropriate political action were they to do so. However this may be negated through an analysis of the two false assumptions that the argument rests on. First and foremost, the argument assumes that these investors are only acting to further their own self-interest and does not consider that such investors believe that E&S integration increases the market value of their investment. The second assumption is that the legal framework in place provides effective regulatory measures for the protection of labour rights.¹⁶⁸

Challenging the mindset of many professionals within the field remains a critical hurdle to the mainstreaming of extra-financial information into investment decisions. However it is submitted that this goal is achievable through concerted efforts aimed at ‘embed[ding] analysis of ESG issues into the normal research process’ and the provision of training to financial professionals.¹⁶⁹ The individual perspectives of those involved in the financial sector reflect the recognition that E&S issues should be integrated into stock valuation and investment strategies.¹⁷⁰ However these individual perspectives have yet to be realised. It has been suggested that this failure to

Series on Short-Termism <http://www.darden.edu/corporate-ethics/pdf/Short-termism_Report.pdf> accessed 14 April 2012.

¹⁶⁶ David Hess, ‘Public Pensions and the Promise of Shareholder Activism for the Next Frontier of Corporate Governance: Sustainable Economic Development’ (2007) 2 Va. L. & Bus. Rev. 22 <www.westlawinternational.com> accessed 16 April 2012.

¹⁶⁷ *ibid.*

¹⁶⁸ *ibid.*

¹⁶⁹ ‘A transformation of Wall Street’s core values is not only possible, but eventually likely to occur...though this will take many years (maybe decades) to achieve, it would represent a generational accomplishment more enduring and meaningful than any of the current preoccupations of politics, since the very foundations of public life would be altered’. William Greider, *Soul of Capitalism: Opening Paths To A Moral Economy* (Simon and Schuster, 2004).

¹⁷⁰ Friedman and Miles (2001); WBCSD, 2005, Saghroun & Eglem, 2006, Jaworski, 2007 as quoted in David Bourghelle, Danyelle Guyatt, Hager Jemel and Céline Louche, ‘Changing conventional practices: Integration of extra-financial information into stock valuation and investment decision processes’ (2007) 6, 9 Working Paper for 20th EBEN Annual Conference, Leuven <ead.univ-angers.fr/~granem08/IMG/doc/Bourghelle-2.doc> accessed 18 March 2012.

act raises questions regarding the sincerity of those in the financial sector.¹⁷¹ That is, that in spite of issuing such statements, financial managers will only incorporate E&S issues when it can be shown that to do so would yield a higher return than to exclude such factors.

Alternatively it has been argued that in spite of this belief being widespread, individuals are hesitant to act, as they presume that others within the group are not of the same opinion.¹⁷² The alternative view is attributed to Orléan's concept of the 'collective belief of the group' within the financial sector. Orléan's discussion on the construction of collective belief of a group and the 'autonomy of group belief' builds on the premise that there are situations where all individuals within a group believe in proposition P, whilst also believing that the group believes in an alternative proposition Q.¹⁷³ This particular definition of group belief differs from the notion of second degree shared or common belief as group belief does not refer to the original belief of the individual but rather demonstrates that each individual is guessing what the group holds the collective belief to be.¹⁷⁴ It is submitted that if individuals continue to exclude E&S considerations by perpetuating conventional risk analysis methods, financial professionals (that is, the individuals) will continue to assume that the financial market (that is, the group) believes that extra-financial information serves no purpose in the decision-making process.

Additionally whilst some investment professionals agree that E&S factors should be taken into account, there is clear indication that these actors fail to challenge conventional analysis processes. It has further been suggested that this outlook is being relayed on to the next generation of financial analysts. A report by the United Nations Environmental Programme Finance Initiative ("UNEP FI") highlighted that young financial professionals are:

typically uninformed on many environmental, social, and governance issues, and cynical about their materiality. Many are unconvinced that their clients would value environmental, social, and governance-focused research, and doubtful that their companies would reward them sufficiently for doing it. Most are

¹⁷¹ Marcel Jeucken, *Sustainable Finance & Banking: The Financial Sector and the Future of the Planet*, (Earthscan Publications Ltd, 2001) 67–68.

¹⁷² David Bourghelle, Danyelle Guyatt, Hager Jemel and Céline Louche, 'Changing conventional practices: Integration of extra-financial information into stock valuation and investment decision processes' (2007) Working Paper for 20th EBEN Annual Conference, Leuven <ead.univ-angers.fr/~granem08/IMG/doc/Bourghelle-2.doc> accessed 18 March 2012.

¹⁷³ André Orléan, 'What is a collective belief?' (CEPREMAP, 2004) 172.

¹⁷⁴ Second degree shared and common beliefs both refer to the primary beliefs of the individuals of the group. They are only considered to be collective insofar as all the individuals in one particular group believe them. *ibid* 171.

unsure how environmental, social, and governance integration could practically be achieved.¹⁷⁵

The report points out that young professionals are wary of straying from conventional business practices as it potentially conflicts with opportunities for increased remuneration, career advancement or in general the mainstay corporate culture that is in place. In addition some professionals have highlighted that the pigeon holing of information, as “non-financial”, is counterproductive, as from the outset, it defines such information as irrelevant to the decision-making process on financial matters.

There are numerous measures, which may be taken to address this particular challenge. As mentioned within the previous Chapter, the States may implement measures to encourage the development of a ‘corporate culture’ which places greater emphasis on the role of human rights within the operations of a business.¹⁷⁶ Alternatively banks, through their senior management, may choose to address these issues, internally, by: circulating information on E&S issues; introducing an incentive for junior analysts to incorporate E&S information into their analysis methods; and finally in refraining from referring to this information as “non-financial” but rather as “extra-financial”.

Addressing The Lack Of Disclosure

In line with the previous points, it is necessary to note that there has been limited public disclosure by companies on the integration of E&S issues into decisions. This lack of information has not only hindered the analysis of the contribution of E&S topics to the financial performance of the company but also contributed to the dominant investment culture. The latter point is directly related to Orléan’s concept of the ‘collective belief of the group’.¹⁷⁷ The failure to report and share experiences/“lessons learned” perpetuates the idea that the majority of financial professionals do not consider that extra-financial information may contribute to the risk analysis process.

It has been suggested that the reluctance to disclose such information is tied to a company’s assessment of the materiality of information used in respect to their investment decisions. The following examples on the treatment of corporate disclosure have been taken from the jurisdictions of the banks

¹⁷⁵ UNEP FI, ‘Generation Lost: Young Financial Analysts and Environmental, Social and Governance Issues’ (2004) 4 <<http://www.unepfi.org/publications/catalogue/index.html>> accessed 18 April 2012.

¹⁷⁶ See text to nn 82-83 for elaboration of the measures that States may take to influence the “corporate culture”.

¹⁷⁷ See text to nn 172-174 for further elaboration. André Orléan, ‘What is a collective belief?’ (CEPREMAP, 2004) 172.

surveyed by this thesis: that is France, the United States of America and the United Kingdom.

In 2012, France adopted new legislation, which governs the reporting practices of all companies that hold headquarters in France and/or operate in France.¹⁷⁸ In essence, Law no. 2010-788 (Grenelle II) requires companies to report on how they take into account the social and environmental consequences of their activity as well as their societal commitments to sustainable development.¹⁷⁹

Within the United States of America, the duty to disclose only arises within set circumstances, such as:

- (1) When a corporation makes a statement which is inaccurate, incomplete or misleading without disclosure of additional information [i.e., the counterfactual conditional]; or
- (2) When a statute or regulation requires disclosure; or
- (3) When a corporate insider trades on confidential information in violation of a fiduciary duty.¹⁸⁰

The United Kingdom, through the Companies Act 2006, requires that the business reviews¹⁸¹ of all quoted¹⁸² companies:

¹⁷⁸ That is, listed and unlisted companies that hold headquarters in another country and also operate within France.

¹⁷⁹ For the purposes of the thesis it is important to note that this article covers actions taken by the company to promote human rights and to address their territorial impact and economic and social activity. Loi n°2010-788 du 12 juillet 2010 portant engagement national pour l'environnement (Grenelle II) (France) s225.

¹⁸⁰ Roeder v. Alpha Industries, Inc., 814 F.2d 22, 26 (1st Cir. 1987); Evanowski v. Bankworchester Corporation, 788 F. Supp. 611, 614 (D. Mass. 1991) (citing Chiarella v. United States, 445 U.S. 222, 235 (1980)). David Monsma and Timothy Olson, 'Muddling Through Counterfactual Materiality and Divergent Disclosure: The Necessary Search for a Duty to Disclose Material Non-Financial Information' (2007) 26 Stan. Envtl. L.J. 137 <<http://heinonline.org>> accessed 17 April 2012.

¹⁸¹ A business review is part of the directors' report and is used 'to inform members of the company and help them assess how the directors have performed their duty under section 172 (duty to promote the success of the company)'. The Companies Act 2006 Chapter 46 (United Kingdom) s417(1) and (2).

¹⁸² 'A "quoted company" means a company whose equity share capital—
(a) has been included in the official list in accordance with the provisions of Part 6 of the Financial Services and Markets Act 2000 (c. 8), or
(b) is officially listed in an EEA State, or
(c) is admitted to dealing on either the New York Stock Exchange or the exchange known as Nasdaq.

In paragraph (a) "the official list" has the meaning given by section 103(1) of the Financial Services and Markets Act 2000'. The Combined Code on Corporate Governance adopts a similar 'comply or explain' approach to the application of the main principles contained within. The Companies Act 2006 Chapter 46 (United Kingdom) s385(2); The Combined Code on Corporate Governance June 2008 (United Kingdom) Preamble and Schedule C.

must, to the extent necessary for an understanding of the development, performance or position of the company's business, include—

...

(b) information about—

- (i) environmental matters (including the impact of the company's business on the environment),
- (ii) the company's employees, and
- (iii) social and community issues,

including information about any policies of the company in relation to those matters and the effectiveness of those policies.¹⁸³

If however, a company is of the opinion that such information does not contribute to 'an understanding of a company's development, performance or position' then they are permitted to exclude it from their reports.¹⁸⁴

Additional stimulus, which has been used to encourage corporate disclosure of information related to E&S issues, includes the introduction of market incentives. Examples of such incentives include increased investor confidence in companies as the disclosure of E&S implementation efforts reveal a company's commitment to following through on their responsibilities and further building the brand value of the company in question.¹⁸⁵

However it is arguable whether these examples provide sufficient inducement for a company to actively disclose non-essential information. A possible solution to this would be if the State were to introduce mandatory regulations requiring companies to report their E&S performance. Alternatively stakeholders may put pressure on the company in question. Investors¹⁸⁶ who hold stocks within the bank or alternatively who are bondholders may introduce this requirement by highlighting the financial and brand value benefits of disclosure. However before investors seek to take such actions, the lack of standardisation should be addressed. Currently there are a number of internationally recognised initiatives, which provide

¹⁸³ The Companies Act 2006 Chapter 46 (United Kingdom) s417(5)(b).

¹⁸⁴ With the proviso that they state which of the information, listed under article 417(5)(b), it does not contain. *ibid.*

¹⁸⁵ David Monsma and Timothy Olson, 'Muddling Through Counterfactual Materiality and Divergent Disclosure: The Necessary Search for a Duty to Disclose Material Non-Financial Information' (2007) 26 *Stan. Envtl. L.J.* 137 <<http://heinonline.org>> accessed 17 April 2012.

¹⁸⁶ Obvious exclusion of coal-mining companies must apply, as there is a clear conflict of interest that arises from the suggestion that these companies will act against their interests.

guidelines for reporting.¹⁸⁷ Thus it is the author's proposal that a common standard regarding disclosure requirements be agreed upon prior to the use of pressure from the public or private sector. The move to standardise reporting requirements will in turn benefit the assessments on the impacts of E&S integration as the information will be available in a coherent format.

3.4 Summary

The Chapter highlighted that E&S integration consists of two elements: management of E&S risks in decision-making and lending processes and the identification of new opportunities for product development in fields directly related to E&S. It demonstrated that there is no standard approach to applying extra-financial information, such as labour rights standards, to commercial financing relationships. It is further evident that the consideration of such extra-financial information remains the concern of select departments within FIs.

The Chapter further demonstrated that there are no inherent challenges presented by the financial products which prevents the application of labour rights standards. Provided with the proper incentives, commercial banks may choose to mainstream E&S issues into their financing relationships through risk analysis processes; the provision of advice to the firm in question; and even the application of certain requirements in the terms and agreements. However the main issue with respect to debt financing appears to be monitoring the company's distribution of funds in their operations. A clear contrast was drawn between these products and the use of project financing, where funds are tied to a specific activity. On the other hand, equity financing raised certain challenges where the shares conferred non-voting rights or if more than one bank was involved in the relationship.

Attention was then turned to a consideration of the challenges of the sector. In brief the assessment focussed on the development of a "business case" that would prompt commercial banks to mainstream E&S issues into their relationships. However the establishment of this stimulus presented numerous challenges. These included the construction of the model; understanding the value of E&S integration; challenging the dominant corporate culture; and addressing the lack of disclosure. It was shown that the model adopted was dependent on the nature of the company and its goals. A dynamic business case was adopted as the goal identified by the thesis is to mainstream E&S into financing relationships. The nature of a commercial bank, as a lender/investor and borrower/investment opportunity,

¹⁸⁷ Consider eg the Global Reporting Initiative (GRI) and Supplier Ethical Data Exchange (SEDEX).

was taken into account and a unique “business case” was presented. The model required that a bank not only understand the general value to be gained from mainstreaming extra-financial information into risk analysis but also to examine the specific benefits that would be gained in respect to their brand and reputation.

An analysis undertaken by the author demonstrated that the establishment of a “business case” is directly impeded by two specific challenges. The first being the undetermined value that extra-financial information, such as that referring to E&S issues, would have on the financial performance and reputation of the bank, and the second, being prevailing financial analysis culture, which chooses to rely solely upon financial information. In addition the lack of disclosure by banks on their experiences was shown to contribute to these previously mentioned challenges.

4 Tracking The Development Of The “Business Case”

Building on the last two chapters, this Chapter will assess the attempts made by the three most prolific banks in the coal-mining sector in respect to mainstreaming labour rights into financing relationships. The intention is to examine the approach of the commercial banks’ regarding their social responsibilities¹⁸⁸ and whether they have taken steps to meet the challenges highlighted under the broad umbrella that is the ‘development of a business case’. Following the guidance and approach adopted of the IFC, the Chapter will establish a framework that will address the challenges and provide a means to assess the efforts of the relevant banks. As noted, the inclusion of extra-financial information has been limited to selected business lines and products within banks.¹⁸⁹ In consideration of this fact, the Chapter will take into account all methods E&S integration and apply the IFC framework to consider whether these forms have resulted in the ‘development of a business case’ which may be transposed to all forms of financing.¹⁹⁰

4.1 The Framework For Assessment

As previously noted, the IFC serves as an important reference point for FIs, in spite of its overall purpose differing to commercial entities.¹⁹¹ Thus for the purposes of this section, the author will first establish the guidelines put forward by IFC as to the establishment of a “business case” and offer examples established by the IFC. The model comprises of four distinct, yet interlinked, steps:

- 1) Developing an approach;
- 2) Integrating E&S management systems into operations;
- 3) Measuring the benefits; and
- 4) Stimulating wider change.¹⁹²

An elaboration of the steps and examples of their application by the IFC will be provided below.

¹⁸⁸ See text to nn 92-97 for an explanation of the social responsibilities of banks.

¹⁸⁹ Such as SRI or forms of targeted finance.

¹⁹⁰ Eg, the financing products examined by this thesis.

¹⁹¹ Reference is made here to the IFC’s holding mainly developmental purposes. See text to n 48.

¹⁹² IFC, ‘Banking on Sustainability’ (IFC, January 2007) 11 <www1.ifc.org> accessed 7-10 March 2012.

4.1.1 Developing An Approach

In short, this stage calls for the FI to recognise the need for E&S issues to be integrated into financing relationships. It requires that FIs identify ‘the risks as well as the opportunities offered by their markets and lines of business, and assess how these can support growth for their clients as well as themselves’.¹⁹³ This step is directly related to the challenge of defining the “business case” in that FIs are required to establish their business goals by undertaking a subjective analysis of the risks and benefits that E&S integration would have to their operations.

For example, the IFC recognises the unique nature of E&S risks for financial institutions, in that the financial sector’s products and services entail that their clients’ activities may constitute certain risks for FIs. These risks are separated into five categories: liability risk, financial risk, reputational risk, credit risk and market risk.¹⁹⁴ Each of these risks may be mitigated through compliance with the relevant E&S regulations and international E&S standards, such as the “core” labour standards adopted by the ILO.¹⁹⁵ Thus in order to mitigate risks posed by clients’, the IFC supports the ‘due diligence’ concept that the SRSR forcefully advanced through the UN GPs. This concept is defined by the IFC as involving the ‘systematic identification, quantification and assessment/evaluation of E&S risks associated with a proposed transaction’.¹⁹⁶ In addition the IFC has identified that the establishment of business lines aimed at E&S integration may be construed as an opportunity, as the bank is identifying and capitalising on a new market/area of business.¹⁹⁷

4.1.2 Integrating Environmental And Social Systems

This step represents a progression from the previous step, in that FIs must act upon the risks and benefits identified. In doing so, it may potentially require a FI to adopt ‘a series of organisational innovations, including formal social and environmental management systems and improvements in

¹⁹³ *ibid.*

¹⁹⁴ Further it should be noted that the nature of the risks, that is type, quantity and severity, depend on geographic context, industry sector, and the type of transaction: corporate, housing, insurance, microfinance, project finance, retail, short-term finance, small and medium enterprise, and trade. IFC, ‘FIRST for Sustainability: Environmental and Social Risk for Financial Institutions’

<<http://firstforsustainability.org/risk-management/environmental-and-social-risk-for-financial-institutions.php>> accessed 15 March 2012.

¹⁹⁵ For further elaboration on the “core” labour standards see text to nn 39-42.

¹⁹⁶ IFC, ‘FIRST for Sustainability: Environmental and Social Due Diligence’ <<http://firstforsustainability.org>> accessed 15 February 2012.

¹⁹⁷ IFC, ‘Banking on Sustainability’ (IFC, January 2007) 11 <www1.ifc.org> accessed 7-10 March 2012.

corporate governance'.¹⁹⁸ The inclusion of E&S systems is considered to contribute to a bank's brand value by not only improving 'the quality of a bank's portfolio' but also lowering 'insurance liabilities and compensation claims'.¹⁹⁹

In response to the risks identified, the IFC holds that:

conducting E&S due diligence on transactions is a critical component of a FI Environmental and Social Management System ("ESMS")²⁰⁰ and [that] its outcome should be factored in to the decision-making process for proceeding with a transaction.²⁰¹

The IFC suggests that risk mitigation may be undertaken through the development of a 'corrective action plan' on measures which the client should adopt in order to mitigate identified E&S risks. A corrective action plan should be established through cooperation and assistance with the relevant client and incorporated into the financing agreement.²⁰² The corrective action plan represents one of the many measures that FIs may adopt in order to reduce their exposure to risks.

Other measures involve the inclusion of E&S covenants, in legal agreements, that detail: positive actions to be adopted by the client; the prohibition of certain activities by clients; the establishment of conditions and requirements that the client must fulfil in order to be granted funds; and the creation of default arrangements, through which a FI may cancel a financing relationship.²⁰³ In addition, a FI is prohibited from financing of activities that are listed on the IFC's exclusion list. The exclusion list establishes a blanket ban on the financing of the 'production or trade in any

¹⁹⁸ *ibid.*

¹⁹⁹ The banks surveyed by the IFC listed a 74 percent reduction in risk, 48 percent improvement in access to international financing, 39 percent improvement in value and reputation and 26 percent improvement in community relations as benefits of E&S systems. *ibid* 7.

²⁰⁰ Manages environmental and social risks, which are associated with the applicant approving activities in a manner consistent with the IFC's Policy on Environmental and Social Sustainability; IFC's Environmental and Social Review Procedure; and the principles established under Performance Standard. IFC, 'International Finance Corporation's Policy on Environmental and Social Sustainability' (1 January 2012); IFC 'Environmental and Social Review Procedures Manual: Environment, Social and Governance Department'; IFC, 'Financial Intermediaries' (Stakeholder Feedback Pamphlet); IFC 'Performance Standards on Environmental and Sustainability' (1 January 2012) <www1.ifc.org> accessed 7-10 March 2012.

²⁰¹ IFC, 'FIRST for Sustainability: Environmental and Social Due Diligence' <<http://firstforsustainability.org>> accessed 15 March 2012.

²⁰² IFC, 'FIRST for Sustainability: Corrective Action Plan' <<http://firstforsustainability.org>> accessed 20 March 2012.

²⁰³ IFC, 'FIRST for Sustainability: Environmental and Social Covenants in Legal Agreements' <<http://firstforsustainability.org>> accessed 20 March 2012.

product or activity deemed illegal under host country laws or regulations or international conventions and agreements, or subject to international bans' or the use of 'harmful or exploitative forms of forced labor/harmful child labor' in operations.²⁰⁴

4.1.3 Measuring Benefits

This stage requires an analysis of the FI's E&S system. The intention is to identify whether the implemented changes are meeting the needs of the stakeholders (as identified under the first step of "developing an approach") and the operations of the company. The IFC highlights that 'the best approaches to sustainability are ones that meet the needs of stakeholders while strengthening a business' own operations and bottom line'.²⁰⁵ This step refers to attempts to understand the value of E&S integration. As noted the perspective of the bank is two-fold.²⁰⁶ Hence in order to answer the question at hand it is necessary to enquire into whether the bank has not only taken steps to understand the general value that is conferred from E&S integration,²⁰⁷ but has also sought to understand what the benefits are for their own brand and reputation.²⁰⁸

The IFC highlights that FIs that take into account international labour and working standards will benefit from reduced risks as a:

positive worker-management relationship ... leads to more productive and stable operations, including a reduced likelihood of strikes, and provides a reputational advantage that comes from enhanced public recognition that good international standards are being followed.²⁰⁹

The institution argues that banks that adopt E&S risk categorisation, will not only benefit from long-term value of enhancing their reputation and brand

²⁰⁴ "Forced labor" is defined by the IFC as all work or service, not voluntarily performed, that is extracted from an individual under threat of force or penalty. In addition "harmful child labor" is defined as 'employment of children that is economically exploitive, or is likely to be hazardous to, or to interfere with, the child's education, or to be harmful to the child's health, or physical, mental, spiritual, moral, or social development'. IFC, 'Financial Intermediaries Exclusion List' <<http://firstforsustainability.org>> accessed 20 March 2012.

²⁰⁵ IFC, 'Banking on Sustainability' (IFC, January 2007) 11 and 26 <www1.ifc.org> accessed 7-10 March 2012.

²⁰⁶ As a lender/investor and alternatively as a borrower/investment opportunity.

²⁰⁷ That is, is there a benefit to be had from the consideration of a potential client's/investment opportunity's approach to E&S issues? Does their observance of labour rights contribute to a favourable reputation/brand/financial performance?

²⁰⁸ That is, what is their individual assessment of the affects of E&S integration on their brand and reputation?

²⁰⁹ IFC, 'FIRST for Sustainability: Labor and Working Conditions' <<http://firstforsustainability.org>> accessed 15 March 2012.

but also by securing future partners and subsequent financing.²¹⁰ In addition the IFC proposes that short/medium-term benefits take the form of improved financial and nonfinancial performances, a reduction in the costs and liabilities incurred, new clients and new markets being opened to the FI.²¹¹ In the long run, the IFC suggests that FIs will increase their market share in ‘sustainability-driven sectors’.²¹²

4.1.4 Stimulating Wider Change

This stage requires that FIs act to ‘strengthen and reinforce the business case’ amongst other FIs. This is done by acting on the previous steps to help ‘build an international consensus around the need for and benefits of social and environmental standards’.²¹³ This step can be seen to meet the challenges arising from the lack of disclosure as it calls upon FIs to communicate their experience to others. It additionally responds to the dominant culture, which is sceptical of the relevance of extra-financial information. It may counter this perspective both internally, through the provision of training and workshops, and externally, through participation in various initiatives and through reporting.

The IFC’s efforts in this respect can be seen through two distinct aspects. The first is that IFC assistance to potential FI clients is conditional on, among other requirements, the applicant/client meeting the E&S requirements and establishing an ESMS system.²¹⁴ The second aspect, as previously mentioned, is based on the nature of the IFC’s role within the financial sector as a provider of advisory and financial products to both public and private actors. The IFC achieves this goal through the wide dissemination of voluntary guidelines, research and publications, on the experiences of the IFC and their clients.

²¹⁰ IFC, ‘FIRST for Sustainability: Business Case for Managing Environmental and Social Risk’ <<http://firstforsustainability.org>> accessed 20 March 2012.

²¹¹ IFC, ‘FIRST for Sustainability: Business Case for Managing Environmental and Social Risk’ <<http://firstforsustainability.org>> accessed 20 March 2012; IFC, ‘FIRST for Sustainability: Benefits of Addressing Environmental and Social Risks’ <<http://firstforsustainability.org>> accessed 20 March 2012.

²¹² IFC, ‘Banking on Sustainability’ (IFC, January 2007) 11 <www1.ifc.org> accessed 7-10 March 2012.

²¹³ *ibid.*

²¹⁴ IFC, ‘FIRST for Sustainability: IFC Environmental and Social Requirements for FI Clients’ <<http://firstforsustainability.org>> accessed 22 March 2012.

4.2 Case Studies

4.2.1 BNP Paribas (France and England)

BNP Paribas (“BNP”) operates in over 80 countries and in 2011 posted a net income of EUR 6,050 million.²¹⁵ It has headquarters in both France and England and provides corporate and investment banking, private banking and asset management.²¹⁶ The bank established 75 financing relationships through the following subsidiaries: BancWest, BGL, BNP Paribas Fortis, Shinhan BNP Paribas Asset Management Co (50 percent ownership), and TKB BNP Paribas Investment Partners OAO (50 percent owned). The author was unable to uncover information that clearly defined the firm’s fiduciary duty to their clients. However it is the author’s submission that the Mission Statement by the bank may be construed as the bank’s position in respect to their duties to their clients. The Mission Statements expresses that ‘loyalty to [the bank’s] clients is a fundamental principle’ and that:

the Group’s employees [shall] strive wholeheartedly to help [their] clients achieve success, taking care of their [client’s] interests while protecting those of the Bank. Savings, loans, insurance, payment systems – whatever the product, no BNP Paribas staff member would ever offer a customer a product knowing that the transaction would not be in his/her true interests.²¹⁷

Developing An Approach

The bank has previously stated that their ‘social and environmental agenda is neither philanthropic nor compliance-driven’.²¹⁸ They have gone on to express their understanding that the incorporation of E&S considerations into operations represents a valuable factor that their stakeholders take into account.²¹⁹ The bank engages in a yearly assessment of the E&S impacts that their transactions have on its stakeholders. Its cross-disciplinary Group

²¹⁵ BNP Paribas, ‘Key Figures’ <<http://invest.bnpparibas.com/en/pid541/key-figures.html>> accessed 23 April 2012.

²¹⁶ BNP Paribas, ‘Legal Information’ <<http://www.bnpparibas.com/en/legal-information>> accessed 23 April 2012; BNP Paribas, ‘BNP Paribas’ <<http://www.bnpparibas.co.uk/en/home/default.asp>> accessed 23 April 2012; BNP Paribas, ‘Core Businesses’ <<http://www.bnpparibas.com/en/core-businesses>> accessed 23 April 2012.

²¹⁷ BNP Paribas, ‘2012 Charter: Our Mission, Our Responsibility’ (2012) 2 <<http://www.bnpparibas.com/en/about-us/publications>> accessed 17 May 2012.

²¹⁸ Chairman’s Statement. BNP Paribas, ‘Report on Environmental and Social Responsibility 2005’ (2006) 4-5 <<http://www.corporateregister.com/>> accessed 23 April 2012.

²¹⁹ The commitment to corporate responsibility is considered to ‘contribute to the Group’s attractiveness, reputation and confidence capital’. Message from the Chairman and the Chief Executive Officer. BNP Paribas, ‘2010 Corporate Social Responsibility Report’ (2011) 3 <<http://www.corporateregister.com/>> accessed 23 April 2012.

Sustainable Development uses the assessment findings for the development of strategies for each of their divisions, business units, territories and functions.²²⁰ The bank recognises the distinction between the direct and indirect impacts that their products and services may cause and the role of stakeholders.²²¹

The bank publicly stated their support of the principles established under the UN PRI and Global Compact²²² and seeks to utilise them throughout their operations and in the development of a framework for the incorporation of E&S issues.²²³ Its commitment to ‘sustainable development’ has been announced via its websites and publications. However in spite of the reference to the implications that their activities have to the social and environmental sphere, the firm does not expressly define the term.²²⁴ This may be attributed to the fact that the bank considers the concept to be ‘constantly evolving’.²²⁵ Nevertheless it should be noted that BNP’s CSR policy, which guides the actions of the bank, is rooted in four main areas:

- 1) Economic responsibility: financing the economy in an ethical manner;
- 2) Social responsibility: pursuing a committed and fair human resources policy;

²²⁰ BNP Paribas ‘Report on Environmental and Social Responsibility 2009’ (2010) 14 <<http://www.corporateregister.com/>> accessed 23 April 2012.

²²¹ BNP Paribas, ‘Glossary’ <<http://media.bnpparibas.com/rse/rapport2010en/glossaire.html#parties>> accessed 23 April 2012.

²²² The United Nations Global Compact (“Compact”) is a ‘policy initiative’, which encourages companies to align operations and strategies with ten principles regarding human rights, labour, environment and anti-corruption. The principles relating to labour rights are derived from the “core” labour standards, as established by the ILO’s Declaration on Fundamental Principles and Rights at Work. The Compact is not legally binding and has been designed as a ‘learning platform’ through which companies are able to meet and discuss challenges that they have encountered. The Compact is limited in its application given the nature of the instrument and the lack of regulatory or standard-setting mechanisms. On the other hand, the role and value of the Compact should not be summarily dismissed, as it is clear that through its materials, it is able to further the understanding of challenges, encourage open dialogue among businesses and promote responsible business practices. UN Global Compact, ‘Overview of the UN Global Compact’ <<http://www.unglobalcompact.org/AboutTheGC/index.html>> accessed 20 June 2012; UN Global Compact, ‘The Ten Principles’ <<http://www.unglobalcompact.org/aboutthegc/thetenprinciples/index.html>> accessed 20 June 2012.

²²³ See the bank’s discussion on the observance of the UN Global Compact’s principles in branches present in “high-risk” countries. BNP Paribas, ‘Report on Environmental and Social Responsibility 2008’ (2009) 25, 49; BNP Paribas ‘Report on Environmental and Social Responsibility 2009’ 13, 64–65 (2010) <<http://www.corporateregister.com/>> accessed 23 April 2012.

²²⁴ BNP Paribas, ‘Sustainable Development’ <<http://www.bnpparibas.com/en/about-us/sustainable-development>> accessed 25 April 2012.

²²⁵ BNP Paribas, ‘Report on Environmental and Social Responsibility 2005’ (2006) 10-11 <<http://www.corporateregister.com/>> accessed 23 April 2012.

- 3) Civic responsibility: combating exclusion, promoting education and culture; and
- 4) Environmental Responsibility: combating climate change.²²⁶

From the outset, the bank's publications make no reference to the inclusion of labour standards and appear to concentrate, for the most part, on the environmental impacts of their clients' operations with 2011's agenda being directed towards activities that address this issue.

The company continued to cater to increasing consumer demand for SRI funds, by extending the SRI investment range offered by their Wealth Management division and in 2010, the bank undertook efforts to incorporate extra-financial information into all its asset classes.²²⁷ The presence of a Reputation Risk Steering Committee in 2005 and subsequent statements on the 'prevention of reputational risks resulting from holding controversial investments' indicates that the bank is aware of the specific risks of certain financing relationships.²²⁸

Integrating Environmental And Social Systems

In general the bank aims to take into account extra-financial information, such as E&S issues, in their analysis of a transaction's credit and operational risk factors. However currently mainstreaming is limited to two investment subsidiaries: BNP Paribas Cardif and Cortal Consors France.²²⁹ Their approach to mainstreaming builds on the portfolio management of SRI funds, which takes into account quantitative and qualitative aspects of financial and extra-financial information.²³⁰

BNP undertakes research on extra-financial information 'with a view to value creation' and takes into account the relevant 'companies' sustainable

²²⁶ BNP Paribas, 'BNP Paribas' commitment to sustainable development' <<http://www.bnpparibas.com/en/about-us/sustainable-development>> accessed 24 April 2012.

²²⁷ BNP Paribas 'Report on Environmental and Social Responsibility 2009' (2010) 13, <<http://www.corporateregister.com/>> accessed 23 April 2012; BNP Paribas '2010 Annual Report' (2011) 105 <<http://www.bnpparibas.com>> accessed 25 April 2012.

²²⁸ The Committee has subsequently been disbanded and in 2007 the Internal Control and Risk Management Committee was granted oversight of 'all matters relating to compliance policy that may impact on reputation risk and professional ethics'. BNP Paribas, 'Report on Environmental and Social Responsibility 2005' (2006) 12; BNP Paribas 'Report on Environmental and Social Responsibility 2009' (2010) 65, 104 <<http://www.corporateregister.com/>> accessed 23 April 2012.

²²⁹ BNP Paribas '2010 Annual Report' (2011) 105 <<http://www.bnpparibas.com>> accessed 25 April 2012.

²³⁰ This information is gathered by a team of 'non-financial analysts who work closely with financial analysts, regularly exchanging points of view on the companies and industries they study'. BNP Paribas 'Report on Environmental and Social Responsibility 2006: The Bank For A Changing World' (2007) 97-100 <<http://www.corporateregister.com/>> accessed 23 April 2012.

development approach in terms of the commitments they make, the resources they allocate, and the results they obtain'.²³¹ In 2008 the bank reportedly factored discrimination issues into their risk management policy.²³² However subsequent risk analysis has failed to demonstrate that discrimination remains a consideration that is taken into account.²³³

In addition, the bank utilises the Equator Principles as a point of reference when assessing the risks involved in proposed project financing transactions. The risk assessment takes into account the performance criteria established by the Equator Principles and categorises the transaction according to its level of risk. However where a transaction is determined to be 'complex from a CSR perspective', it is transferred to the bank's Transaction Acceptance Committees for further review.²³⁴ BNP Paribas also applies sector-specific financing and investment policies throughout its operations to all potential transactions.

Measuring Benefits

It remains unclear how the bank is reviewing its asset management business in order to ensure that they are compliant with the standards established by the Global Compact.²³⁵ Thus whilst these statements appear to indicate that BNP has established a "business case" for the inclusion of extra-financial information, there is limited direct disclosure by the bank on the factors which support this stance. However it is noted that the bank co-founded a four-year initiative, Enhanced Analytics Initiative ("EAI"), which aimed to develop research on the contribution of extra-financial information to financial returns.²³⁶ The EAI represented a catalyst for the analysis of E&S issues as it demonstrated that considerable improvement was being made in

²³¹ BNP Paribas, 'Report on Environmental and Social Responsibility 2008' (2009) 76; BNP Paribas 'Report on Environmental and Social Responsibility 2009' (2010) 66 <<http://www.corporateregister.com/>> accessed 23 April 2012.

²³² BNP Paribas, 'Report on Environmental and Social Responsibility 2008' (2009) 2 <<http://www.corporateregister.com/>> accessed 23 April 2012.

²³³ BNP Paribas, 'Risk Management: A Top Priority for the BNP Paribas Group' <<http://www.bnpparibas.com/node/1095>> accessed 25 April 2012; Risk.net, 'BNP Paribas launches academy to promote risk culture' (31 March 2010) <<http://www.risk.net/operational-risk-and-regulation/news/1598926/bnp-paribas-launches-academy-promote-risk-culture>> accessed 25 April 2012.

²³⁴ A special process is applied to export financing.

²³⁵ See n 221. BNP Paribas, '2011: Registration Document and Annual Financial Report' (2012) <<http://www.bnpparibas.com/>>; BNP Paribas '2010 Annual Report' (2011) 105 <<http://www.bnpparibas.com/>> accessed 25 April 2012.

²³⁶ The bank announced that it allocated 5 percent of its brokerage commissions to the initiative. BNP Paribas 'Report on Environmental and Social Responsibility 2009' (2010) 13 <<http://www.corporateregister.com/>> accessed 23 April 2012.

both the quality and depth of research.²³⁷ However the final report of the EAI highlighted that financial analysts failed to treat extra-financial issues with equal consideration, with environmental issues remaining the focus of the discussion and limited coverage being given to social issues.²³⁸ In short the EAI concluded that the inclusion of extra-financial information improved investment returns over the long run however an exact quantification of those benefits remains challenging.²³⁹

The bank annually undertakes customer and employee surveys and the 2010 findings indicated that CSR remained an important factor for employee engagement. No information was located on the responses of customers to BNP's E&S integration measures.²⁴⁰ Further information on measures taken by the bank to assess the impact of their CSR approach on their reputation and brand was not accessible. In 2009 the bank highlighted a survey by Covalence's EthicalQuote system, which ranked the bank among the Top 20 world banks.²⁴¹

Stimulating Wider Change

In respect to addressing the dominant culture of excluding extra-financial measures internally, the company incorporates sustainable development into business processes and provides training to employees, such as through an online training module on CSR issues and the sustainable development policy.²⁴² The training programme offers specific modules on bank policies, the two of direct relevance focus on the E&S impact of financing activities and SRI. In addition the bank has opened a forum for all stakeholders, especially employees to discuss CSR initiatives.

In respect to fostering change in their external environment, BNP annually releases a CSR report on their activities.²⁴³ Furthermore the bank, through its Asset Management Division, co-founded the previously mentioned EAI.

²³⁷ Enhanced Analytics Initiative, 'Research centre stage: Four Years of the Enhanced Analytics Initiative' (onValues, 2008) <<http://www.unpri.org/research/>> accessed 03 May 2012.

²³⁸ *ibid* 6, 18.

²³⁹ *ibid*.

²⁴⁰ Message from the Chairman and Chief Executive Officer. BNP Paribas 'Report on Environmental and Social Responsibility 2010' (2011) 3 <<http://www.corporateregister.com/>> accessed 23 April 2012.

²⁴¹ The survey measured the ethical reputation of multinationals based on how they are perceived by the world's key media. BNP Paribas 'Report on Environmental and Social Responsibility 2009' (2010) 18 <<http://www.corporateregister.com/>> accessed 23 April 2012.

²⁴² BNP Paribas, 'Embedding Sustainable Development in our Corporate Culture' <<http://www.bnpparibas.com/en/about-us/sustainable-development/making-part-our-corporate-culture>> accessed 26 April 2012.

²⁴³ The 2011 report has not been released, as yet.

Moreover the bank takes part in numerous organisations, such as ORSE (the French research centre for CSR) and EDH (a coalition of French companies that seek to implement the UDHR) and other sustainability initiatives.²⁴⁴

4.2.2 Citi (United States Of America)

The Citigroup operates in 160 countries and can be broken down into two major segments: Citicorp and Citi Holdings.²⁴⁵ Between these two segments, Citigroup provides consumer banking and credit, corporate and investment banking, securities brokerage, transaction services, and wealth management.²⁴⁶ In 2011, the group, which is headquartered in the United States of America, recorded a net income of \$11.1 billion.²⁴⁷ According to the study, the group entered into 72 financing relationships through the following subsidiaries: Bank Handlowy W Warszawie SA and Triton Insurance Company. The 2012 Code of Conduct defines a fiduciary as having ‘a legal duty to act in the best interests of its clients by putting its clients’ interests ahead of its own interests or the interests of its affiliates or employees. A fiduciary also has the duty to act prudently, treat clients fairly, maintain the confidentiality of client information, protect fiduciary assets and provide comprehensive disclosures’.²⁴⁸ All actions taken by the bank ‘are in the best interests of [their] clients, are designed to create economic value, and at the same time are systemically responsible’.²⁴⁹ Thus their approach to corporate citizenship is seen to be in compliance with this definition.

²⁴⁴ The bank is a signatory to the UN PRI and participates in the UNEP FI and is an active participant in the Global Compact initiative. BNP Paribas ‘Report on Environmental and Social Responsibility 2006’ (2007) 97-100 <<http://www.corporateregister.com/>> accessed 23 April 2012; Global Compact ‘Participant Search’

<<http://www.unglobalcompact.org/participants/search>> accessed 20 May 2012.

²⁴⁵ Reorganisation of the business segments was announced in January 2009. Citi, ‘Citi to Reorganize into Two Operating Units to Maximize Value of Core Franchise’ (16 January 2009) <<http://www.citigroup.com/citi/press/2009/090116b.htm>> accessed 20 April 2012.

²⁴⁶ Citi, ‘How Citi is Organized’ <<http://www.citigroup.com/citi/business/index.htm>> accessed 27 April 2012.

²⁴⁷ Citi, ‘2011 Annual Report’ <<http://www.citigroup.com/citi/corporategovernance/ar.htm>> accessed 27 April 2012.

²⁴⁸ Citi, ‘Code of Conduct’ (2012) <http://www.citigroup.com/citi/investor/corporate_governance.html> accessed 27 April 2012.

²⁴⁹ This stance has been consistently upheld throughout the period surveyed by the thesis (see the corresponding annual report for an elaboration of the nature of ‘shared responsibilities’). Citi, ‘2005 Citizenship Report’ (2005) 2, 29; Citi, ‘2011 Global Citizenship Report’ 22 (2012) <<http://www.corporateregister.com/>> accessed 23 April 2012.

Developing An Approach

The bank has consistently taken into account the differing focuses of stakeholder groups that are affected by their operations.²⁵⁰ Their CSR programme focuses specifically on financial inclusion and environmental sustainability however the bank recognises the importance of the UDHR and core labour standards as guiding principles in their operations.²⁵¹ Their 2011 Global Citizenship Report establishes the bank's support for the GPs²⁵² and the Global Compact; however it is the author's submission that, as yet, the bank falls short of recognising the social responsibilities, which arise from their products and services.²⁵³ Instead the bank highlights that their investments and transactions give rise to numerous 'points of influence... across our value chain, from our suppliers, to our employees and operations and to our clients via our investments and transactions'.²⁵⁴

The bank touches upon the E&S risks of banking activities but it fails to enter into a discourse on the specific nature of the risks facing their sector.²⁵⁵ However it should be noted that Citi focuses on the credit and reputational risks that arise from project financing and no further mention was found for the risks involved in financing other transactions.²⁵⁶ In respect to benefits identified, Citi implemented a new business line, OpenLend for Socially Responsible Investors. This programme allows 'investor clients to optimize portfolio returns while satisfying commitments

²⁵⁰ Citi, 'Citizenship: Global Citizenship Report 2009' (2010) 8, 9, 15 and 17; Citi, '2011 Global Citizenship Report' (2012) 1-3 <<http://www.corporateregister.com/>> accessed 23 April 2012.

²⁵¹ Citi, 'Global Citizenship Report 2010' 8 (2011) <<http://www.corporateregister.com/>> accessed 23 April 2012.

²⁵² By expressly stating that they intend to update their Statement on Human Rights to reflect the guidance given by the GPs.

²⁵³ See text to nn 92-97 for a description of the social responsibilities of financial institutions. Further support for this proposition is drawn from the Review Feedback provided by Ceres. Citi, '2011 Global Citizenship Report' 13 (2012) <<http://www.corporateregister.com/>> accessed 23 April 2012.

²⁵⁴ *ibid* 17, 49.

²⁵⁵ Citi's 2009 Statement on Human Rights establishes that the company 'exercise[s] appropriate due diligence on clients to protect the franchise' however a discussion over the risks anticipated is not entered into. Further the 2011 Global Citizenship Report states that further discussion on market specific risks may be included in their 2012 Report. Citi, 'Statement on Human Rights' (August 2009) <<http://www.citigroup.com/citi/citizen/humanrights/index.htm>> accessed 20 April 2012; Citi, '2011 Global Citizenship Report' (2012) 13 <<http://www.corporateregister.com/>> accessed 23 April 2012.

²⁵⁶ 'In 2003 Citi Markets & Banking...developed the Environmental and Social Risk Management...Policy to help address environmental and social issues from both a credit risk perspective and a reputation and franchise risk perspective'. Citi, 'Citizenship Report 2007' (2008) 42 <<http://www.corporateregister.com/>> accessed 23 April 2012; Citi, 'Citizenship: Global Citizenship Report 2009' (2010) 15 <<http://www.corporateregister.com/>> accessed 23 April 2012.

to sustainability goals’ through the alignment of ‘cash collateral investments...with ESG factors’.²⁵⁷

Integrating Environmental And Social Systems

Since 2003, the bank has adopted an environmental, risk and social management process (“ESRM”), which is akin to the IFC’s ESMS. The ESRM assesses potential transactions and categorises them according to three levels of E&S risk.²⁵⁸ Risks are assessed according to the IFC’s PS and Environment, Health and Safety Guidelines.²⁵⁹ In addition, the ESRM unit provides advice on measures that may be used to mitigate the risks identified. The measures recommended differ according the varying degrees of E&S risk involved.²⁶⁰ Moreover it is noted that a transaction is automatically prohibited where the ESRM uncovers evidence of forced labour or harmful child labour.²⁶¹ Thus whilst the company does not expressly state their interpretation of ‘due diligence’, it is submitted that their ESRM constitutes a measure which is intended to meet the ‘due diligence’ requirement. However in spite of this promising initiative, the ESRM is only applied to targeted/project financing relationships, which meet a certain financial threshold.²⁶² It is submitted that the requirement that a financial threshold be met speaks against the proposition that E&S factors may assist when calculating the rate of return on all potential investments.

Measuring Benefits

Citi, through their measurement and reporting of E&S priority areas, seeks to provide evidence of trends and a basis for comparative analysis.²⁶³ The

²⁵⁷ Citi, ‘2011 Global Citizenship Report’ (2012) 50 <<http://www.corporateregister.com/>> accessed 23 April 2012.

²⁵⁸ The three categories are A) expected to have significant adverse social and/or environmental impacts that are diverse, irreversible or unprecedented; B) expected to have limited adverse environmental and/or social impacts that are few in number, generally site-specific, largely reversible and readily addressed through mitigation measures; or C) expected to have minimal adverse impacts. *ibid* 44-47.

²⁵⁹ Prior to 2010, the ESRM Policy also took into account the Equator Principles and Carbon Principles.

²⁶⁰ Eg, a Category C would require fewer measures. An example of one such measure is the inclusion of an Action Plan, as a binding covenant on a financing relationship. Citi, ‘2005 Citizenship Report’ (2006) 33-35 <<http://www.corporateregister.com/>> accessed 23 April 2012.

²⁶¹ Citi, ‘2011 Global Citizenship Report’ (2012) 17 and 43 <<http://www.corporateregister.com/>> accessed 23 April 2012.

²⁶² Citi affirms that the ESRM Policy will only be applied ‘where the use of proceeds is known and tied to a specific physical project or asset’ and meets the following thresholds: \$5 million for equity investments; \$10 million for project finance transactions; and \$50 million for corporate loans, acquisition finance, and debt and equity placements or underwritings. A Statement from Representatives of Socially Responsible Investment Firms. Citi, ‘2005 Citizenship Report’ (2006) 33-35; Citi, ‘2011 Global Citizenship Report’ (2012) 43 <<http://www.corporateregister.com/>> accessed 23 April 2012.

²⁶³ Citi, ‘Global Citizenship Report 2010’ 5, 29 (2011)

company's annual CSR reports contain information on the number of transactions that were subject to the ESRM process. However there is an evident gap in respect to identifying the benefits to be obtained from the application of the E&S system from either a general perspective or from Citi's understanding of their brand. Furthermore, it has been previously noted that the bank failed to achieve a 'gold-standard level of transparency, as its reporting still fail[ed] to discuss with real candor some of the deep-seated challenges it faces and areas of disappointing performance'.²⁶⁴ It is submitted that unfortunately this situation continues to persist.²⁶⁵ This hesitancy to disclose information results in an insufficiency of evidence demonstrating the value that such activities have on financial performance, which in turn proves detrimental to the stance that the consideration of E&S issues is valuable to the financial performance of assets.²⁶⁶

Stimulating Wider Change

Citi's CSR reports highlight that the bank used events and activities within the financing, inter- and non-governmental sectors, as opportunities to discuss their experience with other actors in the field.²⁶⁷ It is questionable whether Citi's training and workshops effectively challenge the traditional financial analysis culture, which some employees within their firm may hold. The 2011 report highlights that training is directed at assisting Citi bankers and risk managers in screening transactions for issues related to the ESRM. Where a transaction is identified as meeting the ESRM requirement, the transaction is subsequently transferred to the ESRM Unit for further review. It is then that the ESRM Unit and "ESRM Champions" are placed with the responsibility for risk analysis and mitigation.²⁶⁸ Hence it is the author's submission that rather than mainstreaming information, such procedures have the effect of entrenching the consideration of extra-

<<http://www.corporateregister.com/>> accessed 23 April 2012.

²⁶⁴ Statement from Representatives of Socially Responsible Investment Firms. Citi, 'Citizenship Report 2006' 9-10 (2007) <<http://www.corporateregister.com/>> accessed 23 April 2012.

²⁶⁵ Consider Citi's current approach to the reporting on ESRM financing relationships and its lack of disclosure on their experience with "London Benchmarking Group Model" following the opportunity highlighted by Mindy Lubber to 'take reporting from good to great, by setting specific targets and goals and explaining your performance. Citi is a company that understands financial targets and accountability, and your citizenship efforts should be managed in the same way'. (President, CERES) Citi, 'Citizenship Report 2007' (2008) 9-10 <<http://www.corporateregister.com/>> accessed 23 April 2012.

²⁶⁶ See text to nn 148-152 for an overview of the effect of E&S integration on financial performance.

²⁶⁷ Examples include the Equator Principles Biodiversity Working Group, consultations with SRSF on the operationalisation of the Framework and GPs and Amnesty International. Citi, 'Citizenship: 2008 Report' 36 (2009); Citi, 'Global Citizenship Report 2010' 8 (2011); Citi, '2011 Global Citizenship Report' (2012) 13, 17, 48, <<http://www.corporateregister.com/>> accessed 23 April 2012.

²⁶⁸ Regional credit risk officers with additional ESRM review and advice responsibilities.

financial information within a select field, namely the domain of ESRM “experts”.

External engagements by Citi include the annual publication of reports on the challenges faced and achievements noted during the relevant fiscal year. The report follows the guidelines established by the Global Reporting Initiative as an attempt to ‘enhance the quality, rigor and utility of sustainability reporting and to provide standardized definitions’.²⁶⁹ In addition, Citi is engaged in various industry initiatives.²⁷⁰ Of particular note was Citi’s participation in the consultations conducted by the SRSG.²⁷¹

4.2.3 Royal Bank Of Scotland (Scotland)

The Royal Bank of Scotland Group (“RBS”), which is headquartered in Scotland, provides personal banking, private banking, business banking and corporate banking products through the following brands: National Westminster Bank (“NatWest”), Citizens, Charter One, Ulster Bank, Coutts, Direct Line and Churchill.²⁷² The group operates in over 40 countries throughout Europe, the Middle East and Asia.²⁷³ In 2011 it announced a £6095 million net profit.²⁷⁴ The Group supplied 68 financing relationships through ABN AMRO, Citizens Financial Group, Coutts & Company, Greenwich Capital, NatWest, Royal Bank of Scotland, Royal Bank of Scotland Coutts Bank and Ulster Bank. A definition of “fiduciary duty” was unable to be located. However it should be noted that the RBS holds that their CSR approach contributes to the long-term performance and brand value of the company.²⁷⁵ Thus it is the author’s submission that their approach is consistent with their fiduciary duty to their clients.

Developing An Approach

In 2008, RBS suffered a record loss of £24.1bn.²⁷⁶ As a consequence, the bank’s reputation and credibility amongst numerous stakeholder groups was

²⁶⁹ Citi, ‘2011 Global Citizenship Report’ (2012) 6 <<http://www.corporateregister.com/>> accessed 23 April 2012.

²⁷⁰ Such as the Global Compact and UNEP FI. BANKTrack, ‘Citi Bank Profile’ <<http://www.banktrack.org>> accessed 18 May 2012.

²⁷¹ Citi, ‘2011 Global Citizenship Report’ (2012) 17 <<http://www.corporateregister.com/>> accessed 23 April 2012.

²⁷² RBS Group, ‘Key Facts about RBS’ <<http://www.rbs.com/about/business-strategy/key-facts.html>> accessed 03 May 2012.

²⁷³ *ibid.*

²⁷⁴ RBS Group, ‘Annual Report and Accounts 2011’ (2012) <http://www.investors.rbs.com/report_subsidary_results> accessed 03 May 2012.

²⁷⁵ Stephen Hester, Group Chief Executive. RBS Group, ‘Sustainability Report 2009: Changing the way we do business’ 4-5 (2010) <<http://www.corporateregister.com/>> accessed 23 April 2012.

²⁷⁶ This figure is considered to be the ‘largest annual loss in UK corporate history’, Philip Hampton. RBS Group, ‘Sustainability Report 2008’ (2009) 4-6, 22

negatively impacted. Taking this into account, the bank has sought to repair their reputation through a step-by-step process aimed at restoring confidence in their company.²⁷⁷

RBS has five themes, which frame their approach to sustainability efforts: 1) fair banking; 2) supporting enterprise; 3) employee engagement; 4) safety and security; and 5) citizenship and environmental sustainability.²⁷⁸ The bank regularly engages with major stakeholder groups in order to determine the direction of their CSR efforts and to establish the materiality of topics discussed in their CSR reports.²⁷⁹ RBS recognises the various environmental, social and ethical (“ESE”) issues, which arise through their own operations and that of their clients and has made a public commitment to respect the rights established under the UDHR and Global Compact throughout their sphere of influence.²⁸⁰

The bank has expressed that unsustainable financing relationships may give rise to both ESE and reputational risks. As a result, they have announced their intention to implement a process of responsible lending.²⁸¹ In response to the growing interest from investors in ethical lending policies, the bank established a SRI engagement programme and in 2012 plans to embed E&S criteria into the country risk assessment procedures.²⁸²

<<http://www.corporateregister.com/>> accessed 23 April 2012; RBS Group, ‘Annual Report and Accounts 2008’ (2009) 1-6 <http://www.investors.rbs.com/report_subsidary_results> accessed 08 May 2012; BBC, ‘RBS shares plunge on record loss’ (19 January 2009) <<http://news.bbc.co.uk/2/hi/business/7836882.stm>> accessed 08 May 2012; BBC, ‘RBS reports record corporate loss’ (26 February 2009)

<<http://news.bbc.co.uk/2/hi/business/7911722.stm>> accessed 08 May 2012.

²⁷⁷ Philip Hampton (Group Chairman). RBS Group, ‘Sustainability Report 2008’ 4 (2009) <<http://www.corporateregister.com/>> accessed 23 April 2012.

²⁷⁸ RBS Group, ‘Sustainability Report 2011: Building a sustainable RBS’ (2012) 1 <<http://www.corporateregister.com/>> accessed 23 April 2012.

²⁷⁹ RBS Group, ‘Sustainability Report 2011: Building a sustainable RBS’ (2012) 39 <<http://www.corporateregister.com/>> accessed 23 April 2012.

²⁸⁰ See text to nn 35, 37-40 and n 221 for an elaboration of the rights established. RBS Group, ‘RBS Group Position on Human Rights’

<www.rbs.com/content/dam/rbs/Documents/Sustainability/RBS-Statement-on-Human-Rights.pdf> accessed 08 May 2012; RBS Group, ‘Sustainability Report 2011: Building a sustainable RBS’ (2012) 4, 8, 11, 33, 34, 39 <<http://www.corporateregister.com/>> accessed 23 April 2012; RBS Group, ‘Sustainability FAQs’

<<http://www.rbs.com/faqs/sustainability.html#what-is-our-ethical-policy-for-customer-lending-and-investments>> accessed 07 May 2012.

²⁸¹ Stephen Hester (Group Chief Executive). RBS Group, ‘Sustainability Report 2009: Changing the way we do business’ 4-5 (2010) <<http://www.corporateregister.com/>> accessed 23 April 2012.

²⁸² The Country Risk Assessment Process previously only considered political and economic factors. RBS Group, ‘Sustainability Report 2009: Changing the way we do business’ (2010) 29; RBS Group, ‘Sustainability Report 2011: Building a sustainable RBS’ (2012) 33-34 <<http://www.corporateregister.com/>> accessed 23 April 2012.

Integrating Environmental And Social Systems

The Group Sustainability Committee (“GSC”), which operates at the Board level, oversees the management of ESE risk policies.²⁸³ Members of RBS’s divisions are responsible for implementing the policy, with support from GSC and the Central ESE Advisory Unit. The assessment of risks posed by clients is performed on an individual case-by-case basis and through reference to numerous policies.²⁸⁴ Of particular relevance are the following two policies: the Human Rights Statement²⁸⁵ and ESE Risk Policy. The bank’s Human Rights Statement directly refers to the principles established under the UDHR and the UN Global Compact.²⁸⁶ The ESE Risk policy, which is used to assess transactions where the use of funds is known and the company involved will be operating in higher ESE risks, makes direct reference to labour rights.²⁸⁷ Through this process, the company’s commitment, capacity and track record in managing ESE risks are taken into account. The RBS adopts a similar risk assessment to the IFC and categorises the level of risk involved in a financing relationship as follows: Normal, Sensitive, High or Prohibited. Where a potential financing relationship is considered to be “Sensitive” or “High”, an additional forum is convened to discuss the reputational risks involved.²⁸⁸

The 2011 report highlighted that efforts had been taken to implement the application of the ESE Policy Statements throughout the bank’s divisions. However it is notable that RBS’s policy on E&S factors serves as a screening tool for potential clients rather than a factor, which is taken into account when assessing the financial viability of a relationship. In addition to the ESE screening processes, the RBS applies the Equator Principles to all transactions related to project financing.

²⁸³ RBS Group, ‘Environmental, social and ethical (ESE) risk’ <<http://www.rbs.com/sustainability/citizenship-and-environmental/ese-risk.html>> accessed 05 May 2012.

²⁸⁴ Such as the Environmental Statement, Anti-Bribery and Corruption Statement, Group Code of Conduct. RBS Group, ‘Policies’ <<http://www.rbs.com/sustainability/governance-reporting-engagement/policies.html>> accessed 07 May 2012; RBS Group, ‘Sustainability FAQs’ <<http://www.rbs.com/faqs/sustainability.html#what-is-our-ethical-policy-for-customer-lending-and-investments>> accessed 07 May 2012.

²⁸⁵ RBS Group, ‘RBS Group Position on Human Rights’ <www.rbs.com/content/dam/rbs/Documents/Sustainability/RBS-Statement-on-Human-Rights.pdf> accessed 08 May 2012.

²⁸⁶ Thereby supporting the inclusion of labour rights standards. See text to nn 35, 37-40 and n 221.

²⁸⁷ RBS is currently in the process of applying this policy to existing clients in order to review whether their operations comply with RBS guidelines/procedures. RBS Group, ‘Sustainability Report 2011: Building a sustainable RBS’ (2012) 33 <<http://www.corporateregister.com/>> accessed 23 April 2012; Telephone interview with Fiona Robertson, Communications and Reporting Manager, RBS Group Sustainability (14 June 2012).

²⁸⁸ RBS Group, ‘Policies’ <<http://www.rbs.com/sustainability/governance-reporting-engagement/policies.html>> accessed 07 May 2012.

Measuring Benefits

In spite of RBS hosting meetings with SRI and ESG analysts, and SRI briefing events on the development of risk systems, the bank's focus remains on measuring the reputational benefits gained from E&S integration.²⁸⁹

In 2010, the bank used a number of surveys, studies and discussion groups to assess public opinion on their approach to E&S issues and the corresponding impacts on their reputation.²⁹⁰ The research and analysis gathered from this exercise was subsequently passed on to the Group Board through the Global Reputation Dashboard.²⁹¹ The bank is currently developing business case metrics on their E&S activity.²⁹²

Stimulating Wider Changes

This particular approach to ESE integration is conveyed to RBS Markets and International Banking employees through training and tools on how 'human rights considerations relate to decision making'.²⁹³ However the author submits that the phrasing of this term makes it unclear whether the bank views extra-financial information, such as human rights considerations, as helpful in the financial analysis of the investment. In respect to external impacts: the bank produces an annual report on CSR programmes; provided feedback in the development of the responsibilities of business under the UN "Protect, Respect and Remedy" Framework; and regularly engages with non-governmental organisations and industry organisations to discuss experiences and developments within the field.²⁹⁴

²⁸⁹ RBS Group, 'Sustainability Report 2010: Building a Sustainable RBS' (2011) 11 <<http://www.corporateregister.com/>> accessed 23 April 2012.

²⁹⁰ Feedback was collected through customer satisfaction surveys; focus groups; online feedback; annual employee opinion surveys; UK public opinion research; MP and investor perception studies; research with ESG investment analysts; senior management meetings with Government Commissions; and media evaluation and perception studies. RBS Group, 'Sustainability Report 2010: Building a Sustainable RBS' (2011) 8 <<http://www.corporateregister.com/>> accessed 23 April 2012.

²⁹¹ The Group Board is the 'principal decision-making forum for the company' and the Global Reputation Dashboard is a 'practical management tool that is structured to highlight areas and issues that require attention'. RBS Group, 'Sustainability Report 2010: Building a Sustainable RBS' (2011) 8 <<http://www.corporateregister.com/>> accessed 23 April 2012

²⁹² Email from Duncan Young (Head of Reporting and Engagement | RBS Group Sustainability) to author (18 May 2012).

²⁹³ Expansion of training to other employees is currently being undertaken. RBS Group, 'Sustainability Report 2011: Building a sustainable RBS' (2012) 33 <<http://www.corporateregister.com/>> accessed 23 April 2012.

²⁹⁴ Such as participating in: the UNEP Finance Initiative; the Equator Principles steering committee; the 2012 Rio+20 Conference; and chairing the Global Compact's United Kingdom network. 'Sustainability Report 2011: Building a sustainable RBS' (2012) 8, 33 <<http://www.corporateregister.com/>> accessed 23 April 2012; BANKTrack, 'RBS Bank Profile' <<http://www.banktrack.org>> accessed 18 May 2012; Telephone interview with

4.3 Summary

The Chapter has attempted to trace the development of a “business case” for mainstreaming E&S issues into financing relationships by adopting the IFC’s framework for a ‘dynamic business case’. The framework consisted of four interlinked steps, which when combined, address the issues highlighted in the previous Chapter. The steps established are as follows:

- 1) Developing an approach;
- 2) Integrating E&S management systems into operations;
- 3) Measuring the benefits; and
- 4) Stimulating wider change.

The Chapter took into account the fact that the consideration of E&S issues remained concentrated within selected business lines and undertook an examination of all forms of E&S integration.

The case studies undertaken highlighted that each of the banks’ definition of fiduciary duty allowed for a CSR approach to be adopted. It has been demonstrated that the banks seek to understand the impacts that their products/services have on stakeholders and that these findings influenced the approach by the relevant banks. It is the author’s opinion that of the three case studies taken, BNP Paribas stands out as the bank, which is most compliant with a “business case” model for mainstreaming extra-financial information into financing relationships.

BNP Paribas’s yearly assessments of E&S impacts are used in the development of tailored strategies for each of their divisions, business units, territories and functions. In contrast, Citi’s risk assessments centre on their project financing relationships and further they appear to only acknowledge their responsibility as being confined to ‘points of influence’. Finally, RBS’s approach is unique in that their reputation was particularly impacted by the global financial crisis. Thus their approach to E&S integration is viewed as one of many means adopted in their efforts to restore their reputation.

Each integrates an E&S system, which is based on the structure and format of the Equator Principles. However it is notable that of the three banks, BNP is the only one, which has expressly stated that extra-financial information, may be useful towards the creation of value.

Measuring the benefits of E&S integration appears to be a challenge for each of the banks. Special attention was given to BNP, on account that its

Fiona Robertson, Communications and Reporting Manager, RBS Group Sustainability (14 June 2012).

objectives appeared to match that of the thesis. An analysis of the company's CSR reports highlighted that the company had invested resources in attempts to understand the value of extra-financial information. However the analysis also demonstrated a noted lack of disclosure on the measures taken to assess the personal benefits brought by their efforts. Whilst the view that extra-financial information may be used, as an additional measure, in value creation is an important step by the bank; their lack of acknowledgment and disclosure of its personal benefits signifies that the full advantages of E&S integration are not recognised. This not only contributes to the traditional financial analysis culture, as those in the field are not informed of the full benefits, but also fosters uncertainty on the real value of E&S integration. Thus, it is the author's submission that in order for a "business case" to be viewed as effective and sustainable, due attention should be paid to not only the general value of E&S integration but also the personal benefits that it has on a company's brand and reputation.

5 Conclusions

Development in the thinking around human rights and business issues has previously been undertaken in a haphazard fashion without a clear focal point to centre the discussion around. However the introduction and global endorsement of the UN “Protect, Respect and Remedy” Framework in 2008 and the UN Guiding Principles in 2011 has allowed for subsequent discussion on the direction and nature of State and corporate human rights responsibilities to take a clear focus. That being said, it is evident that a number of issues remain unanswered. Through the questions posed, the author has taken the opportunity to delve into certain issues, which remain up for deliberation.

The obligations of the State to regulate the actions of a third party, such as commercial banks, has come under consideration; with the thesis highlighting that many Governments continue to suffer from a state of ‘horizontal’ incoherence, whereby human rights obligations are not being effectively implemented across governmental departments. In addition the determination of the extraterritorial obligations of States in respect to the rights established by the UDHR principles continues to be debated with many challenging the proposition that States must oversee the global operations of companies headquartered within their territory.

An exploration of the social responsibilities that arise from the bank-client relationship has highlighted the unique nature of the financial sector. It has demonstrated that the nature of the relationship and product must be taken into account when determining the scope and character of responsibilities. Further it has illustrated that the consideration of extra-financial information, such as that relating to labour rights standards, does not conflict with the fiduciary duty of financial managers to their clients but rather may be seen as complementary to such obligations.

It has subsequently been shown that there are no manifest barriers precluding the integration of labour rights into financial products. The thesis has highlighted that the integration of labour rights concerns may be implemented through risk analysis processes; the inclusion of positive or negative covenants; and/or plans detailing strategic approaches of clients into financing agreements. Thus the fundamental challenge that is highlighted is convincing commercial banks that the inclusion of extra-financial information is to their own benefit and that it will prove to be advantageous in the assessment of returns on potential financing relationships. However this submission is impeded by numerous factors

such as: division on the construction of the “business case” model; a clear lack of empirical evidence demonstrating the utility of extra-financial information; and the widespread investment culture which relies upon traditional forms of analysis.

The thesis took into account the two differing objectives of a commercial bank²⁹⁵ and highlighted that the development of an effective “business case” model for mainstreaming required a dual approach. It was suggested, by the author, that these approaches required a bank to not only understand the general value of E&S integration but also to recognise the specific contribution of E&S integration to their brand value and reputation. The case studies of the banks selected, demonstrated that BNP Paribas was the closest to following this proposed construction.

In addition, it was illustrated that each of the banks implements internationally recognised E&S principles²⁹⁶ in their activities. However the degree to which this was done was dependent on the bank’s analysis of their stakeholders’ interests. This point, which has been raised throughout the thesis, underlines the important role that stakeholders have in influencing the direction and priorities of commercial banks, as it is clear that banks are inclined to respond to recognised risks and opportunities.

Furthermore in spite of E&S integration being limited to select business lines²⁹⁷ within the bank, it is evident from the assessment taken, that a significant impediment to the realisation of a “business case” for mainstreaming is the lack of understanding on the impacts of E&S integration. It was subsequently shown that this issue is compounded by a lack of disclosure by all banks involved. The thesis has provided examples of State and stakeholder actions that may be taken to encourage further disclosure by banks. It is the author’s submission that States and stakeholders must undertake efforts to encourage disclosure, as it is this lack of understanding, which has come to represent the final hurdle that must be overcome in order to convince financial professionals of the real merits of E&S integration.

²⁹⁵ That is as a lender/investor and borrower/investment opportunity.

²⁹⁶ Internationally recognised through the relevant international human rights standards and initiatives.

²⁹⁷ Such as SRI funds, other forms of asset management, project finance and other forms of targeted finance.

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