ANNUAL OECD ROUNDTABLE ON CORPORATE RESPONSIBILITY

The OECD Guidelines for Multinational Enterprises and the Financial Sector

Summary of the Discussion

18 June 2007

This document reproduces the summary of the Roundtable discussion which was held on 18 June 2007. It will form part of the forthcoming publication "Annual Report on the OECD Guidelines for Multinational Enterprises 2007".

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Ambassador Elisabeth DAHLIN, Head of Swedish Partnership of Global Responsibility, Swedish Ministry for Foreign Affairs who chaired the Roundtable

and the following invited speakers and respondents from government, business, labour, international organisations and non-governmental organisations:

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SUMMARY OF THE DISCUSSION

The Preface of the OECD Guidelines for Multinational Enterprises states that the Guidelines "aim to ensure that the operations of these enterprises are in harmony with government policies, to strengthen the basis of mutual confidence between enterprises and the societies in which they operate, to help confidence between enterprises and the societies in which they operate, to help improve the foreign investment climate and to enhance the contribution to sustainable development made by multinational enterprises. In order to achieve these goals, the 40 governments adhering to the Guidelines have committed themselves to participating in the Guidelines' unique implementation procedures.

Every year the OECD holds a Roundtable on Corporate Responsibility in conjunction with the annual meeting of the National Contact Points (NCP). The purpose of this annual meeting is to assist NCPs in performing their role of promoting and implementing the OECD Guidelines for Multinational Enterprises while taking into account emerging issues and relevant policy developments.

This year's annual OECD Roundtable on Corporate Responsibility was devoted to the OECD Guidelines for Multinational Enterprises and the Financial Sector. Its objectives were: 1) learning from practitioners about current trends in corporate responsibility practices and instruments in the financial sector and the challenges ahead, and 2) exchanging views with financial actors on the various ways in which the OECD Guidelines can best support their efforts to promote corporate responsibility.

The Roundtable was divided into four sessions each introduced by a lead speaker and followed by a panel of respondents drawn from the financial sector, government, international organisation, business, labour and civil society circles.[1] The following summary of the discussions is based on the four sessions' main themes. The Roundtable was held under the Chatham House Rule[2] and this summary conforms to that Rule.

1. Taking Stock of Corporate Responsibility Practices in the Financial Sector

The profile of corporate responsibility in the financial sector has significantly evolved in the last 25 years. According to the study commissioned by the OECD to EIRIS,[3] after being primarily confined to the niche area of ethical funds for a number of years, corporate responsibility issues are increasingly being integrated into the mainstream activities of financial institutions. This is reflected in the significant rise in codes of conduct, management systems and reporting by individual financial institutions on environment, social and governance issues, as well as the emergence of corporate responsibility instruments by specific segments of the industry.

This development can be largely attributed to public pressure and increased recognition of the business case for corporate responsibility. Increased awareness by the public that the financial sector can make a difference in promoting corporate responsibility through its direct and indirect investments (estimated at US$140 trillion or three times world GDP) has led to a demand that financial institutions act more responsibly. Financial institutions themselves have also come to realise that their sustainability over the long run is increasingly linked to the environmental and social sustainability of their activities and that failure to act can put their long-term profitability at risk. The business case for corporate responsibility has become particularly compelling in light of environmental degradation and global warming -- as reflected in the recent blossoming of “green products” -- and increased allegations of human right violations and non-observance of basic labour rights. Positive externalities of responsible business conduct can include a stronger relationship with suppliers and customers, more efficient use of resources, better relations with local communities and a greater power to attract, motivate, and retain staff. Reputational risks have also increased as a result of corporate scandals or human rights violations. These reasons can explain the more recent involvement of large financial institutions, such as pension funds or large banks, in extra-financial issues.

The corporate responsibility picture varies by categories of financial institutions, issues and regions. As suggested by the EIRIS study and confirmed by Roundtable participants, various segments of the financial sector have different exposure to corporate responsibility risks and practice corporate responsibility in different ways. Life insurance companies stand out as having developed more advanced corporate responsibility policies and covered a wider range of corporate responsibility issues than other types of financial institutions. Ethics and environment issues (in certain regions) also appear to have been addressed more extensively than human rights. Geographically, European-OECD financial institutions have been more active than those from all other regions except in regards to the performance of North American financial institutions in the area of codes of ethics. Financial institutions in OECD-Asia-Pacific have been particularly active recently in developing green products, which suggests opportunities for “leapfrogging” in the corporate responsibility field. These regional differences may be attributed to cultural and regulatory factors. In North America, the widespread litigation culture and strict regulatory requirements may not have particularly encouraged voluntary initiatives on the part of individual institutions. Europe, in contrast, has a long tradition of corporate responsibility involvement, and European civil society has historically been more vocal regarding such issues.

Investment banks, private equity consortiums and institutional investors have the greatest ability to influence corporate responsibility. Due to the nature of their interactions with their business partners, investment banks, private equity consortiums, superannuation and pension funds, and asset managers have the greatest ability to promote responsible business conduct. They are often the primary financiers of investment capital and involved in large-scale infrastructure projects that can have a direct impact on such issues as labour, human rights, and environment. Their clients are also demanding that they do more in this area. Although corporate responsibility instruments and practices have not yet fully entered the growing market of private equity and hedge funds, it was recognised that these financial institutions have a strong potential to influence as well. The fact that pension funds and other actors have started to invest in these markets could lead them to a greater corporate responsibility engagement. Others participants expressed concern however that private equity and hedge funds still represent too much of gap in the corporate responsibility field.

There is ample room for further involvement by the financial sector. According to the EIRIS study, 50 per cent of all financial institutions do not have corporate responsibility policies and only 30 per cent engage in serious corporate responsibility reporting. This may be a reflection of the complexity of corporate responsibility issues and a need for more time to address them. At the same, concerns associated with globalisation are likely to continue. Overall, Roundtable participants felt that the integration of corporate responsibility issues into the mainstream activities of financial institutions will remain an ongoing and evolving process.

2. Financial Sector Instruments for Responsible Business Conduct

Financial institutions have not waited for governments to act. Leading financial institutions have produced a number of corporate responsibility standards and principles for the industry, including the Equator Principles for major projects financed by banks and the UN Principles for Responsible Investment (UN PRI) for the investment activities of institutional investors. Such initiatives provide distinct frameworks for the incorporation of responsible business conduct into investment strategies and in doing so, facilitate the promotion of corporate responsibility practices geared to the specificities of the financial sector. In addition, these initiatives attest to financial institutions' recognition of their ability to influence the parameters and frameworks in which companies operate. This recognition has been accompanied by an emphasis on understanding both the direct and indirect impact that companies can have on corporate responsibility issues and a realisation that financial institutions generally have a greater indirect impact. A representative from the investor community distinguished financial sector corporate responsibility instruments as "process standards" for ensuring that certain issues are taken into account, rather than as mechanisms for achieving specific corporate responsibility goals. The implication of this characterisation is that positive outcomes will not automatically ensue from the implementation of corporate responsibility instruments, although the likelihood of such outcomes may be increased.

The Equator Principles are a financial industry benchmark for determining, assessing and managing social and environmental risks in project financing. They apply to all new project financings globally with total project capital costs of US$10 million or more across all industry sectors. In adopting the Equator Principles, a bank undertakes to provide loans only to those projects whose sponsors can demonstrate their ability and willingness to comply with comprehensive processes aimed at ensuring that projects are developed in a socially responsible manner and according to sound environmental management practices. Financial institutions subscribing to the Principles represent 80 to 85 per cent of the project finance market. In recent years, a greater number of banks in developing countries have begun adhering to them. Most recently, the possibility of banks applying the Equator Principles to non-project financing is beginning to emerge. This suggests that there may be a trend for the Equator Principles to apply across a broader range of financial services. It was noted that two crucial issues facing Equator Principles financial institutions are accountability and transparency, particularly providing more information in the public domain. Additional challenges cited include: ensuring that banks have the internal expertise to appropriately apply the Equator Principles, that problems are being properly assessed and that the Equator Principles are adopted by more financial institutions from emerging economies. The possibility was also raised that there may be a need for more rigorous interpretation.

The UN PRI aims to incorporate environmental, social and governance issues into mainstream investment decision-making and ownership policies. This instrument was developed by institutional investors for the financial sector and is backed by 200 major investment organisations from 25 countries, representing US$10 trillion.[4] Signatories include asset owners, investment managers, and professional service partners. The PRI has achieved significant growth from its launch in April 2006 with 20 original signatories representing US$2 trillion in assets under management. The significant increase in support for the PRI was described as a signal to the investment chain that a large concentration of capital takes environmental, social and governance issues very seriously. However, it was cautioned that there is a need for the UN PRI to quickly demonstrate its ability to affect change if it is to gain further credibility and momentum. Representatives from the investor community described the strength of the PRI as its ability to complement other important corporate responsibility initiatives such as the OECD Guidelines for Multinational Enterprises and the UN Global Compact, and offer flexibility in how the Principles are adopted and create a platform for future alliances and initiatives. For example, it was noted that with further encouragement by governments institutional investors' support for the UN PRI could extend to explicit support for the OECD Guidelines, demonstrated by their own observance of the Guidelines and their promotion of the Guidelines to clients and stakeholders. The Guidelines provide a unique tool to measure how investee's companies may be at risk if they do not appropriately observe the standards of the Guidelines.

The Norwegian Government Pension Fund was given as an example of how financial institutions draw on corporate responsibility instruments. The Norwegian Government Pension Fund - Global is one of the largest single-owned funds in the world (close to US$50 billion in assets). The owners of the fund are the Norwegian people and future generations of the Norwegian people. In 2004, The Norwegian Ministry of Finance introduced ethical guidelines to ensure long-term returns for the owners and to influence the companies in which it invests by encouraging them to respect the environment and fundamental human and social rights. These managing principles are built on an international structure that includes the OECD Guidelines for Multinational Enterprises, the UN Global Compact and more recently, the UN PRI. Fund managers use these guidelines as a point of reference in dialogue with other investors and portfolio companies, as a reporting tool and as an aid in identifying issues in their own use of ownership rights. The fund's objectives moving forward include strengthening shareholder rights, protecting children's rights and protecting the environment.

The experience of a private bank was also presented at the Roundtable. The bank is a leading global financial services firm with assets of US$1.4 trillion, operating in more than 50 countries. It first established a code of conduct in 1999 and in 2004 opened an office of environmental affairs. Although it is not engaged in project finance, it has adopted the Equator Principles and uses them as the basis of its policy, applying them where use of proceeds is designated for loans, bond underwriting, equity underwriting, and financial advisory. Its corporate responsibility policy covers environmental and social risk, climate change, the bank's own internal footprint and strategic partnerships. To aid clients in reducing their own greenhouse gas emissions, the firm has launched various green products such as green mortgages and invests in green affordable housing and plans to continue expand such initiatives. It has also set specific targets to reduce its own greenhouse gas emissions, launched energy efficiency projects, invested in green energy sources and established employee awareness initiatives. The bank said it is committed to a forward-looking approach to its operations and recognised that more time is needed to understand the effectiveness of its current strategies before committing its resources to additional corporate responsibility areas.

One representative from the NGO community presented examples of private financial actors alleged to have failed to meet the standards promoted by the OECD Guidelines and those of the financial corporate responsibility instruments they had publicly subscribed to. The examples given concern investments in the mining and oil and gas sectors, the pulp industry and weak governance zones causing significant environmental damage or human rights violations. This participant highlighted the importance of scrutinising individual business activity supported by the financial sector.

Improvements can be made in monitoring and implementation. The financial sector needs effective tools to measure compliance with existing corporate responsibility financial instruments. While evaluation products are available in the markets, more resources should be devoted to the development of more sophisticated performance indicators and their continuous monitoring over time. A number of issues seem to warrant further discussion. One key question is that of what entities should control and bear the cost of monitoring processes, especially in light of the fact that corporate responsibility initiatives are largely voluntary. Other participants referred to the appropriate use of the term "violation" and types of "sanctions" which could be invoked, such as reputational or legal. Others suggested that further clarification by financial sector practitioners of the nature of their fiduciary duty may also facilitate improvements in implementation processes. It was agreed that members of civil society, including NGOs, will continue to have a valuable role to play in the monitoring process.

Support from government is seen as crucial to the success of financial sector instruments for corporate responsibility. There was consensus that there is still a need for governments to create an environment conducive to the promotion of corporate responsibility issues. A representative from the investor community noted that investors are not going to lead on these issues until they see stronger support from government for responsible business conduct initiatives. The political will of host countries to actively promote and effectively implement responsible business conduct can impact the success of financial sector corporate responsibility instruments. This is of particular relevance in emerging countries and weak governance areas so that financial service institutions are able to comply with their own standards. The OECD has also recognised this point with the establishment of tools such as the OECD Risk Awareness Tool for Weak Governance Zones.

3. The Supporting Role of the OECD Guidelines

The OECD Guidelines have unique characteristics. The OECD Guidelines are one of the most comprehensive corporate responsibility instruments in existence today and furthermore are endowed with a unique implementation mechanism. The Guidelines' international legitimacy is derived from the fact that they are backed by governments and have the wide support of business, labour and other stakeholders. The Guidelines bring an overarching and structured framework to corporate responsibility work. The value of their "federating" role has increased as a result of the proliferation of corporate responsibility codes and instruments. As one representative from the financial community noted, the Guidelines are "an enormous diplomatic achievement."

The Guidelines apply to the financial sector. The most important players in the financial sector are active in the international arena and therefore qualify as multinational enterprises on the basis of the premises of the Guidelines. All ten major policy areas covered by the Guidelines have relevance for the operations of the financial sector notably environment, human rights and labour relations and bribery. In addition, it was noted that the Guidelines call upon financial institutions to encourage where practicable their business partners to apply principles of corporate conduct compatible with the Guidelines. Several speakers indicated that due to their economic power and the breadth of their activities, financial institutions, particularly larger ones, have a wide sphere of influence. Given this, they are well positioned to promote the Guidelines in the broader context of their investment-like relationships or the so-called investment nexus. At the same time, the degree of influence that a given financial institution may have can vary significantly from partner to partner, issue to issue and operation to operation. Flexibility is therefore required in considering the application of the Guidelines; however, this flexibility should not be seen as a limiting factor but rather as an opportunity. Moreover, even those financial institutions that do not meet the criteria for multinational enterprises under the Guidelines can utilise the principles and standards embodied in the Guidelines in support of their corporate responsibility work.

The financial community can take advantage of the Guidelines in various ways. The Guidelines' substantive standards for responsible business conduct can be used or referred to in company decision-making processes and corporate responsibility tools. For example, the Guidelines provide clear guidance on how financial institutions could collect and disseminate information about their corporate responsibility work, a highly relevant area for financial institutions. They also provide guidance on other relevant issues such as employment and industrial relations, environment, corruption, taxation, competition and consumer protection. While financial practitioners are at a certain organisational distance from the enterprises with which they engage, the Guidelines can still provide support to their corporate responsibility work specifically in regards to their supply chain management relationships and interactions with business partners. They can also support joint corporate responsibility work with their partners in existing consortia or other arrangements with financial investors.

The Guidelines have yet to live up to their potential. With the opportunities come the challenges. Several representatives of the financial sector said that the Guidelines are not sufficiently known, understood or utilised by the financial community. Special efforts should be deployed by NCPs to explain and promote the Guidelines to financial institutions, especially those financial institutions that have the greatest ability to influence responsible business conduct. Unabated and consistent government support for the Guidelines is crucial as investors rely on governments to provide the normative or ethical frameworks within which they operate. Closer attention should be given to human rights and the precautionary and polluter pays principles. A representative from the institutional investor community noted that there is a need to explain the Guidelines' operational and evaluation potential. The articulation of the sphere of influence and boundaries of responsibility of financial actors also requires further consideration. The recent initiative by OECD Watch and the European Social Investment Forum (EUROSIF) to develop a series of fact sheets to help investors and social responsible investment agencies better understand the scope of the Guidelines was noted with interest. This will help PRI signatories make more effective use of the Guidelines as an instrument for measuring risks and opportunities as regards corporate responsibility policies and practices.

The good functioning of the "specific instances" facility is key. While the recognition of the value of this unique mechanism was widely shared, several participants felt that there is room for improvement. Representatives from the institutional investor community argued that the industry needs a reliable mechanism to assess the corporate responsibility performance of companies in which they hold shares in a fiduciary capacity. Over the past few years there have been enormous strides in encouraging these fiduciary owners to demand of the companies they own, higher standards of management and ethical behaviour. This also has placed them in the position of "arbiter" of the business conduct of these companies. It was said that it would be very useful to the industry if the special instance facility becomes more instrumental in helping investors determine whether the companies they own are adequately managed so that they can intervene accordingly. Companies themselves should welcome this as are they are also confronted with frivolous claims. Further thought should thus be given on how the specific instance facility could be transformed into an arbitration or adjudication system capable of resolving investment disputes and discouraging frivolous claims. The next few years provide a unique window of opportunity for the NCPs to act. Other participants however felt that the value of the specific instance facility was precisely its non-adversarial mechanism for the resolution of disputes. Still other participants shared the view that the mediation and judiciary roles of the Guidelines' implementation facility could be used at different stages of the specific instance process and were not mutually exclusive.

One representative from civil society pointed to apparent inconsistencies in the handling of recent cases involving the financial sector and suggested possible criteria for determining the admissibility of cases in the future including: ownership or management of the asset; ability to influence ownership rights or investor duties; contributing to unethical acts or emissions through the provision of funds and/or services; facilitating, authorising, participating in, tolerating or knowingly ignoring adverse activities by others; length of the business relationship; systematic and repeated engagement in adverse activities; and, signatory to the Equator Principles. Other perceived shortcomings of the NCP process include limited resources, lack of independence from governments and frequent NCP turnover.

Extending acceptance of the OECD Guidelines' principles and standards to non-adhering emerging economies remains perhaps the most serious challenge. The recent emergence of new players from major non-OECD countries has raised the importance of the "level playing field" issue in the global financial arena. Several representatives from the financial community indicated that their continuous support for corporate responsibility may be affected by the lack of adherence of these new actors to corporate responsibility standards comparable to those applied by their counterparts in the developed world. The OECD can make a valuable contribution as it is in constant dialogue with these countries. Adherence to the OECD Declaration on International Investment and Multinational Enterprises, of which the Guidelines are an essential part, can also be in the self-interest of financial institutions from emerging markets that have started investing abroad. A "stronger case" can be made for the benefits that these actors and their home countries could derive from implementation of responsible business conduct practices. The ongoing project with China on governmental approaches to public policies promoting responsible business conduct was considered a good example of what the OECD should do in this regard.

4. Exploring Synergies between the OECD Guidelines and Financial Sector Instruments

The OECD Guidelines and the financial sector corporate responsibility instruments such as the Equator Principles and the UN Principles for Responsible Investment are complementary. Several participants agreed that the OECD Guidelines, the Equator Principles and the UN PRI share common values and have mutually reinforcing missions. The Guidelines contain substantive standards in several business areas that can be taken into account in the implementation of financial sector instruments, while the financial sector initiatives identify the reporting and other management policies that deserve the special attention of financial practitioners concerned with business ethics. The implementation processes are complementary as well. While financial instruments focus on engagement and reporting, the Guidelines provide a unique facility for providing guidance and helping resolve issues that may arise in concrete situations. Together, these instruments constitute a major force for corporate responsibility. However, several Roundtable participants noted that for their combined potential to be realised, political will and a real commitment by all players to make them work is essential.

Increased cooperation and coordination between the Guidelines and financial sector instruments should be pursued. Mutual recognition of the complementarities between different instruments and the increased use of the Guidelines as a reference tool will help financial institutions develop more effective corporate responsibility policies. Several participants stressed that governments need to reiterate before financial institutions their strong support for the Guidelines and encourage them to make greater use of the Guidelines. The financial sector will also benefit from a clarification of the articulation between the Guidelines and financial sector corporate responsibility instruments. In addition, financial institutions can turn more often to the specific instances facility of the Guidelines for the resolution of issues arising from their operations, and further thought could be given on how this unique tool can be associated with the implementation processes of the financial sector's instruments. Several participants considered that increased cooperation between the financial sector and the National Contact Points on the supporting role of the OECD Guidelines will be consistent with the statement made by the G8 at their recent summit in Heiligendamm on investment and social responsibility.

Notes

1. See the agenda for the Roundtable in Appendix 2A.

2. Chatham House defines the Chatham House Rule as follows: *When a meeting, or part thereof, is held under the Chatham House Rule, participants are free to use the information received, but neither the identity nor the affiliation of the speaker(s), nor that of any other participant, may be revealed.* For more information please see www.riskythinking.com/glossary/chatham_house_rule.php.

3. This study can be accessed at www.oecd.org/daf/investment/guidelines.

4 UNEP Finance Initiative, The Working Capital Report, July 2007, page 1, www.unpri.org/twcr/WorkingCapital.pdf.