



ORGANISATION FOR ECONOMIC  
CO-OPERATION AND DEVELOPMENT

**ANNUAL OECD ROUNDTABLE ON CORPORATE RESPONSIBILITY**

***THE OECD GUIDELINES FOR MULTINATIONAL ENTERPRISES  
AND THE FINANCIAL SECTOR***

**SUSTAINABLE DEVELOPMENT, BUSINESS ETHICS  
AND THE FINANCIAL SECTOR**

This paper reproduces a contribution which UNEP invited the OECD to make in 2003 during the early phase of the development of the UN Principles for Responsible Investing. This contribution was published in "Values to Value: A Global Dialogue on Sustainable Finance", UNEP (2004). It is circulated as background documentation to the discussion at the Roundtable on Corporate Responsibility on 18 June 2007.

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***Fiduciary responsibility: “An obligation to act in the best interests of another party. This type of obligation typically exists when one person places special trust and confidence in another person and that responsibility is accepted.”***

This definition of fiduciary responsibility – with its use of the terms “obligation”, “trust” and “confidence” – underscores a fundamental and long-recognised truth: ethics is the bedrock of successful financial intermediation and, by implication, of successful financial systems and market economies. The ability of financial intermediaries to make credible commitments to a certain number of rules and standards of behaviour is the source of investors’ trust and confidence – ethics makes trust possible. For example, in retail financial services, customers’ belief that financial institutions are “ethical” (in the sense that they observe rules for behaviour that protect customers’ interests) makes them willing to entrust these institutions with responsibility for managing their assets. Thus, the ability to credibly commit to ethical behaviour has always been a core business requirement for financial institutions. Recent developments in financial markets attest to the dangers of undermining this ethical foundation and to the heavy costs that are incurred when financial systems do not function effectively. The United Nations Environment Programme’s Finance Initiative takes a broad look at the question of the relationship between ethics and financial intermediation – the programme looks at what financial institutions can and should do to contribute to sustainable development of the societies in which they operate.

In its invitation to contribute to this publication, UNEP has asked the OECD to focus on the public sector’s role in helping financial intermediaries make this credible commitment to ethics, broadly defined. The OECD – which helps its 30 member governments to make public policy more efficient and effective -- has decades of experience in analysis of the legal institutional and regulatory framework for financial institutions. Binding laws as well as official supervision and regulation form the core of governments’ efforts in the financial oversight. However, this core is supplemented by the delegation of certain functions to other institutions. Typically some rule-setting and -enforcing functions are delegated to “self-regulatory organisations” (SROs) such as industry associations and stock exchanges. These activities are integral parts of the broader framework in which the public and private sectors collaborate to make financial systems work effectively (though recent events have led both public and private actors to reconsider the way their actions fit together). In the future, governments’ contributions to defining the financial sector’s responsibilities in promoting sustainable development will no doubt reflect this traditional reliance on both law and official regulation alongside more flexible forms of public-private cooperation.

In thinking about the government role vis-à-vis the sustainable development impacts of the financial sector, it might be useful to reflect on the following:

***Focusing the financial sector on its core mission.*** Societies invest in legal frameworks and the other public goods used by their financial services sectors so that these sectors can perform an essential function. Financial intermediaries’ core responsibility is to maximise shareholder value and, in so doing, to help allocate capital to high value investment projects and to manage and allocate risks. This core mission is inextricably bound to the idea of sustainable development through many complex linkages. The most obvious linkage is financial institutions’ influence on economic, social and environmental performance via their capital allocation function – these institutions help sort through menus of investment projects that have different economic, environmental and social impacts.

***Obeying the law – a non-trivial task.*** Of course, financial service providers have to do more than just maximise shareholder value – they must also obey the law. This can be significant challenge for global companies with thousands of employees dispersed across thousands of legal and regulatory

environments. Thanks to progress made over the last twenty years or so<sup>1</sup>, it is now common for companies to use management systems that make information available where it is needed, maintain records, establish responsibilities as well as checks and balances and create incentives for compliance. Through their wholesale lending activities and their relations with the companies represented in their investment portfolios, financial services play a key role in encouraging non-financial companies' to develop these managerial capabilities. Governments can also encourage these developments – for example, by building them into broader regulatory and law enforcement strategies (e.g. the role played by the Eco Management and Audit Scheme in the European Union's environmental strategy).

***Recognising that environmental and social risks are also financial risks.*** Environmental and social risks are financial risks and should be treated as such by companies, financial institutions and governments. Governments have a role in ensuring that these risks are recognised, evaluated and disclosed. A recent example of this is the United States' Sarbanes-Oxley Act, which will create powerful incentives – rooted in securities market regulation – for disclosing any material risk to companies' balance sheets. More generally, governments can help by making use of existing requirements for reporting material risks – these should include not just narrowly defined financial risks, but also broader risks to the bottom line arising from the environmental and social (e.g. human and labour rights) dimensions of companies' operations.

***Developing financial tools.*** Financial institutions have been good at developing and using financial tools for dealing with sophisticated valuation and risk management problems. They have also begun work on developing tools (valuation techniques, disclosure standards) relevant for environmental liabilities and risks. However, more needs to be done to refine and disseminate these tools. Financial institutions can bring their significant valuation and risk management expertise to bear on the problem of developing such tools – this is one of the financial sector's major contributions to sustainable development. They can also use their close relations with non-financial companies to promote and disseminate the use of these tools.

***Clarifying the business case for sustainable development.*** Through its investment analysis function, the financial sector can play an important role in clarifying the business case for sustainable development. At the present time, this business case is assumed to exist, but has not been well documented. The investment process involves sorting through menus of potential projects and selecting those which deliver the highest risk-adjusted net present value. The business case for sustainable development is embedded in this broader investment and financial analysis problem. With better information and the right incentives, financial companies can shed light on this business case and can help to distinguish between sustainable development projects that can be undertaken unilaterally by the private sector (because they are good investments in their own right) and those where public inputs (e.g. regulation, subsidies, tax incentives) are needed if the project is to be undertaken.

***Risks of contagion.*** A company's tolerance of unethical behaviour in one area tends to spill over into other areas. Trying to prevent unethical behaviour in one area of business from spilling over into another area is not generally an option. Sooner or later, the fact that wrong-doing is seen as being a winning strategy in one part of the company will impact on practices in other parts of the company. Companies need to make a commitment to ethics across the board. Governments can help by passing the message that observance of a broad range of ethical standards is crucial for building effective ethical and legal compliance systems.

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<sup>1</sup> See *Corporate Responsibility: Private Initiatives and Public Goals* (OECD 2001) for extensive documentation of corporate practices in the area of environmental management.

*Using global corporate responsibility instruments.* The OECD Guidelines for Multinational Enterprises and the United Nations Global Compact provide two complementary models for helping companies make this broad commitment to appropriate standards of conduct. The OECD Guidelines provide recommendations backed by 39 governments in such areas as labour management, environment, consumer protection and the fight against corruption<sup>2</sup>. Through their distinctive follow-up mechanisms, the Guidelines provide a channel through which governments can encourage companies' commitment to ethical conduct and can support financial institutions' efforts to contribute to sustainable development.

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<sup>2</sup> For more information about the OECD Guidelines for Multinational Enterprises, see [www.oecd.org/daf/investment/guidelines/](http://www.oecd.org/daf/investment/guidelines/).