FairFinanceGuide®
International

# Methodology for the assessment of responsible investment and financing policies of financial institutions

# Fair Finance Guide International

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## Introduction

After the collapse of the American investment bank Lehman Brothers in September 2008, a global banking crisis unfolded. All over the world, banks had to be bailed out with taxpayers' money by their governments, to avoid a total collapse of the financial system. As a consequence, people in many countries still bear the brunt of severe austerity measures while economic recovery is still pending.

As this global economic crisis originated from the irresponsible investment and risk-taking behaviour of banks across the globe, there clearly is a strong need for change. Furthermore, insight is growing that financial institutions play a crucial role in major worldwide social and environmental problems (from land grabbing and slavery to climate chance), caused by companies, they provide with financial resources for irresponsible investments. Banks should develop products and services tailored to the needs of society as a whole, supporting sustainable economic development and social justice. With their credits, banks can help companies and governments perform their tasks, run their operations and enable the development of innovative products and solutions to tackle the multiple social and environmental crises we are facing. By lending money and stimulating productive investments, banks can play a key role in every segment of human activity.

While international agreements on strengthening bank regulations have taken some steps to prevent massive bailouts of banks in the future, they fall short of addressing the fundamental changes needed in the banking sector. Until now, this task is left mostly to civil society organizations which are increasingly holding banks accountable for the social, environmental and human rights' consequences of their loans and investments.

One of these civil society initiatives is the Fair Finance Guide International project, launched in January 2014; a collaborative effort of CSO coalitions including Belgium, Brazil, France, Germany, Indonesia, Japan, the Netherlands, Norway and Sweden.

In each country, the CSO coalitions have set up Fair Finance Guide-websites which customers and other interested parties can use to compare the policies and practices of the main banking groups in their country, and in some countries also other types of financial institutions. These websites rank and compare the investment and finance policies of financial institutions on a range of issues related to governance (from transparency to remuneration) to cross-cutting themes (from labour rights to climate change) and to industries (from agriculture to manufacturing). Additionally, the Fair Finance Guide International coalitions regularly publish case studies on specific topics, trying to assess if and how the financial institutions apply sustainability criteria in their daily practices. This way, consumers can make informed choices on what banks to use; and CSOs can use this information to pressure banks to improve their policy and practice, and to influence regulators to develop and impose adequate regulation.

This document, prepared for the Fair Finance Guide International network, presents the Fair Finance Guide International methodology which will be used to assess and rank financial institutions' policies. This methodology is developed by Profundo, based on international norms and standards and on the views and visions of the CSOs collaborating in Fair Finance Guide International.

By comparing and ranking investment and finance policies, Fair Finance Guide International will hopefully be successful in stimulating banks and insurers, as well as other financial institutions, to rethink their role in society. Responsible financial institutions are much needed: to face all social and environmental challenges the global community is confronted with, a strong and responsible financial sector is needed to efficiently allocate investment funds and find risk-sharing solutions.

Developing clear and ambitious policies on social, environmental and economic rights, is a necessary first step in that direction. We hope the methodology described in this document will help the present and future CSO coalitions collaborating in Fair Finance Guide International, to stimulate financial institutions across the world to embark upon this road.

We thank all the researchers and experts from the coalitions within the Fair Finance Guide International network for their contribution to developing this methodology.

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# Chapter 1 Objective and methodology

## 1.1 Overview

This methodology is meant to verify which sustainability issues play a role in the policy that financial institutions apply when assessing credit requests and selecting investments. It sets out the elements against which Fair Finance Guide International will measure financial institutions' environmental, social and economic policies. These elements are grouped under three headings:

- cross-cutting themes (see Chapter 2);
- sector themes (see Chapter 3); and
- operational themes (see Chapter 4).

Chapter 1 gives an overview of the objective and methodology of the Fair Finance Guide International. The objective of the Fair Finance Guide International is to encourage Corporate Social Responsibility (CSR) at financial institutions. Section 1.2 describes the principles of CSR and explains the role financial institutions have in promoting CSR amongst companies they invest in or finance. Furthermore, in this section it is explained how the Fair Finance Guide International hopes to stimulate a race to the top by enabling consumers to compare financial institutions' level of social and environmental responsibility.

In section 1.3 five types of financial institutions are listed. The role of commercial banks, investments banks, insurance companies, pension funds and asset managers in the financial sector is explained.

The assessment of investment policies is explained in section 1.4. It describes what issues and sectors are taken into account and how certain principles should be applied by a financial institution to be granted a score. The section elaborates on the scope of investment policies, the sectors that are relevant to particular financial institutions, the documents that should be assessed and the collective policies that could be taken into account.

The Chapter is concluded by section 1.5 on the use of case studies to supplement the Fair Finance Guide International policy review.

## 1.2 Objective and principles

This methodology has been developed for the Fair Finance Guide International, which is a collaborative effort of CSO coalitions in Belgium, Brazil, France, Germany, Indonesia, Japan, the Netherlands, Norway and Sweden.

The objective of the Fair Finance Guide International is to encourage Corporate Social Responsibility (CSR) by financial institutions. According to ISO 26000, CSR can be defined as the "responsibility of an organization 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 organization and practised in its relationships."1 The OECD Guidelines for Multinational Enterprises argue that corporations should "contribute to economic, environmental and social progress with a view to achieving sustainable development."[2]

This means companies (including financial institutions) should not only adhere to legislation and regulations in the countries where they operate, but also are expected to comply with widely supported international conventions, standards, and initiatives that recognise sustainability problems and offer solutions for them - even where these standards are not included in local legislation. Companies should comply with these standards in the business operations of their own enterprise and its subsidiaries, but they should also expect their suppliers to comply. (See the EU 2014 Compendium of Corporate Social Responsibility National Public Policies for a comprehensive overview of CSR standards.)[3]

According to Fair Finance Guide International, financial institutions' CSR efforts should primarily concern their core activity: providing capital. Financial institutions offer their clients a wide range of financial services with which they enable companies, governments, and private clients to acquire capital for all kinds of activities. This can encompass activities that lead to human rights violations or environmental pollution, as well as activities that contribute to ending malnutrition or improving biodiversity.

The question Fair Finance Guide International raises is, therefore, to what extent financial institutions support, through their financial services, activities that contribute to a socially just and sustainable world. According to Fair Finance Guide International, financial institutions should expect companies to whom they provide capital, as well as their suppliers, to comply with widely supported international standards and initiatives.

Financial institutions should record these expectations and make them publicly known in their policies for specific issues and sectors. When assessing these policies, in most cases, legislation and regulations are not explicitly considered, because the Fair Finance Guide assumes that financial institutions expect the companies to whom they provide capital to comply with the law. Due to this focus on financial services, issues related to financial institutions' own business operations, such as their human resources policies and paper, water and energy use, are largely left out of the equation.

In the framework of Fair Finance Guide International, websites are being set up in a number of countries - at present Belgium, Brazil, France, Indonesia, Japan, the Netherlands and Sweden - which customers and other interested parties can use to compare the policies *and* practices of the main banking groups in their country. Fair Finance Guide International primarily focuses - through these websites, publications and the media - on consumers who are customers of one of the financial institutions (by means of a current account or checking account[i], savings account, credit card, mortgage loan, insurance, or an investment account).

The Fair Finance Guide International network enables consumers, the media and other interested parties to compare financial institutions and to encourage them (and their subsidiaries in asset management and insurance) to grant financial services in a responsible way.

By comparing financial institutions both on the contents of their policy as well as on the choices they make in practice when supplying financial services, Fair Finance Guide International stimulates competition between financial institutions with regard to Corporate Social Responsibility. The Fair Finance Guide International network hopes to stimulate a process that leads to increasing tightening of social, environmental and economic policies (*race to the top*) and to enhance the constructive role financial institutions can play in creating a just and sustainable world.

[i] Current Accounts in British English, Checking Accounts in US English.

## 1.3 Financial sector

### 1.3.1 Commercial banks

Banks are intermediaries in the money and capital markets: they ensure that the capital of, *inter alia,* private clients and institutions such as pension funds with money to invest, is allocated to (other) private clients and institutions who need money to finance their activities. The banks broadly fulfil this role in two ways:

- Commercial banking: commercial banks use the savings of individuals, organisations, institutions and companies to provide loans and other financial products to other individuals, organisations, institutions and companies. We discuss this role in this section;
- Investment banking: Investment banks do not lend money directly: they are intermediaries between different groups of clients, including companies, governments, wealthy individuals and institutional investors. These clients pay a fee to investment banks for financial services, such as issuing shares or bonds and selling these to investors. We discuss this role in section 1.3.2.

Traditional commercial banks, which usually operate retail banking (for the public) and corporate banking (for businesses and other larger institutions), attract monies from individuals, organisations, institutions and companies in the form of savings or deposits, and invest these monies by providing loans and other financial products to other individuals, organisations, institutions and companies. Banks set out these amounts in their *balance sheets* in two columns: on the right, how the bank has obtained the monies (the *liabilities*), and on the left, how the bank has spent the monies (the *assets*). Below we describe both categories:

- **Liabilities**

  The *liabilities* of the bank – all its incoming capital - can be divided into *debts* and own *capital*. The *own capital* represents the monies of the owners of the bank. These can be its shareholders, other financial institutions or - in case of a *cooperative bank*, its members, who may be its customers, employees or other local banks. Their capital consists of:

  - monies raised by selling shares in the bank; and
  - the net profit the bank has made in past years.

  The *debts* of the bank include all other monies it attracts, including:

  - monies that private clients, institutions and companies have deposited in current (checking) and savings accounts;
  - loans from other banks;
  - bonds that the bank has sold to investors; and
  - financial derivatives: debts due to swaps[ii], futures[iii], or options.

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[ii] A swap is a derived financial product where two parties swap money flows. For example, at an interest swap two banks may swap the interest payments of two loans with one another. The objective of this can be to mitigate the risk of, for example, an interest increase or even to speculate on an interest decrease. So in case of a swap, banks have both a debt as well as an asset.

[iii] A future is a financial contract between two parties who commit themselves to trade a certain amount of a product or financial instrument for a predetermined price at a given point in time.

- **Assets**

  All incoming monies at a bank are invested in various types of *assets*. In other words: the sum of the liabilities is always exactly equal to the sum of the assets. Banks may have invested in the following types of assets:

  - the offices and furnishings of the bank itself;
  - other real estate, such as offices, parking lots and shopping centres;
  - mortgage loans and credit to private clients;
  - loans and other types of credit to companies, governments and investors such as hedge funds;
  - loans to other banks;
  - investments in shares and bonds of companies and in bonds of governments, but also in private equity (see section 1.3.3); and
  - investments in financial derivatives: swaps, futures and options.

Not all banks invest in all these types of assets. Savings banks mainly invest in investments in shares and bonds, mortgage banks mainly in mortgage loans and commercial banks mainly in loans to companies and governments. Over the last decades, some commercial banks have started to invest more in financial derivatives.

All monies that have been placed with a bank in current (checking) and savings accounts by private clients, institutions and companies, may in principal be used by the bank for all possible bank investments: from mortgage loans to private clients to investments in international companies and financial derivatives. This means that someone who has placed money in a current or savings account at a bank will not necessarily know what his or her money is used for. Banks are free to invest the monies of savers at their own discretion. Therefore, it is of great importance that banks provide insight into what policy is maintained for its investments.

### 1.3.2 Investment banks

As well as acting as intermediaries on the money and capital markets in the traditional way discussed in section 1.3.1, some banks are active in *investment banking*[iv]: this means that rather than lending money directly, they act as intermediaries between different groups of clients, including companies, governments, wealthy individuals and institutional investors. These clients pay a fee to investment banks for their financial services.

[iv] The term investment bank may be confusing, as investment banks themselves typically *invest* less than traditional (commercial) banks. Investment banks mainly help other financial institutions to invest.

Broadly, two main activities can be distinguished:

- *Underwriting*: Investment banks are mainly involved in assisting companies or governments to raise finance by issuing and selling *securities* such as shares and bonds to investors. For companies and governments, selling securities to pension funds, insurance companies, asset management companies and private investors is an important way to attract new capital. The investment bank will value the company, write a prospectus, promote the securities and "underwrite" the securities. Underwriting means that the investment bank buys the securities from the company for a fixed price and in the days after that, tries to sell the securities to institutional investors for a slightly higher price. In this way, the revenue for the company is guaranteed. The investment banks aims to ensure that there are sufficient buyers for the securities and that their clients, the companies and governments raising the finance, receive the best possible revenue. On a predetermined date the investment bank purchases the shares and bonds of its client at a fixed price, and sells them to the investors who can sign within a few days.

- *Brokerage* (sometimes called *corporate finance*): in this case, the investment bank doesn't purchase anything itself, but only acts as a broker who mediates between the buyer and the seller.

Investment banking services are mostly provided to listed companies and governments, but they can also be granted to non-listed companies. For most banks that are involved in investment banking, it is a matter of course that they apply the policy for bank investments for these financial services (see section 1.3.1). In the case of *underwriting* this is also very logical, because the banks themselves invest in the respective shares and bonds - although usually only for a few days. The risks the banks take are therefore comparable to those of other bank investments.

In case of banks that are only involved in *brokerage*, the bank does not make an investment, and it is therefore not always the case that the policy for bank investments also applies to brokerage accounts. However, the Fair Finance Guide International believes that for these types of financial services, the same sustainability criteria should apply as for commercial banking, because in this role banks also provide capital to companies and governments.

### 1.3.3 Insurance companies

An insurance company hedges risks. An insurance is a contract which ensures that the insurance company pays damages to the insurant in certain situations (such as damages caused by fire or by an accident, in the event of death, or for medical costs due to disease) in exchange for a certain premium the insurant pays.

When the parties conclude the contract they don' t know whether damages will ever have to be paid or, if so, how much damages will be paid. The insurance companies invest the premiums that people pay for their insurance. This is why insurers are key players on the capital market: they create a flow of society's capital from private people and institutions such as pension funds, towards (other) private people, companies and governments who need money in order to finance their activities.

Insurance companies receive money from several sources and they invest this money in several ways in private people's, companies' and governments' activities. On the insurers' balance sheet these flows are put next to each other: on the right you see how the insurer obtained his money (the *liabilities*), on the left you see how the insurer spent the money (the *assets*). An explanation of these two categories follows:

- **Liabilities**

  An insurer's *liabilities* – i.e. all the money the insurer has received – may be divided into obligations and equity. The equity is the money of the insurer's owners. They may be private people, other financial institutions or – in the case of a cooperative insurance company – the insurants themselves. The equities consist of:

  - money that has been obtained by selling the insurance company's shares to the owners;
  - the net profit made by the insurer over the years.

  All other money obtained by the insurer falls within the insurer's obligations. Especially:

  - premiums paid by private people, institutions and companies;
  - loans of other financial institutions;
  - bonds sold by the insurer to investors;
  - financial derivatives: debts due to swaps[v], futures[vi] or options.

- **Assets**

  All the money received by an insurer is invested in several kinds of assets (properties and claims). In other words: the liabilities always are always equal to the assets. An insurer may invest in the following types of assets:

  - the offices, including furniture, where the insurance company staff works;
  - other real estate like office buildings, multi-story car parks and shopping malls;
  - mortgage loans and consumer credits to private people;
  - loans to other financial institutions;
  - investments in i.a. assets and bonds of companies and government bonds, as well as in private equity (see 1.3.3);
  - investments in financial derivatives: swaps, futures or options.

Not every single insurance company invests in all these kinds of assets. Moreover, insurers deal with investments on their own account and risks and investments on the policyholder's account. With regard to the latter kinds of insurances, the insurant bears the risk more or less. Insurants may decide for some part how their money is invested, usually according to a certain kind of investments profile that brings along either more or less risks. However, in the end the insurer is responsible for the choices made with regard to the investments.

Basically, the insurance company can freely use the premiums paid by private people, institutions and companies, for all kinds of possible investments: varying from mortgage loans to private people, to investments in international companies and financial derivatives. This means that someone who pays insurance premiums, may not know what exactly his or her money is invested in. The insurers are free to invest the insurants' money on their own discretion - including the premiums on their own account. For this reason it is very important that insurers are transparent about their policy regarding investments.

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[v] A swap is a derivative in which two parties swap cash flows. E.g. in the case of an interest swap, two insurers swap the interest payments of two loans. The aim may be a limitation of the risks of, say, an increase of the interest rate or perhaps to speculate upon a decrease of the interest rate. Thus when engaging in a swap transaction the insurer both has a debt as well as property.

[vi] A future is a financial contract between two parties to buy or sell at specified future date a certain quantity of a product or a financial instrument for a price agreed upon today.

### 1.3.4 Pension funds

Pension funds are established by employers to provide pensions for their workers when they retire. The fund, paid for by the employer and employees, is a common asset pool meant to generate a stable income over the long term. Larger companies may run their own pension funds, but often a financial intermediary runs the fund. In many countries, pension funds are the largest institutional investors.[4]

Pension funds receive money from their clients and they invest this money in diverse assets and investment strategies.

On the pension fund's balance sheet these flows are put next to each other: on the right you see how the fund obtained his money (the liabilities), on the left you see how the insurer spent the money (the assets). An explanation of these two categories follows:

- **Liabilities**

  A pension fund's liabilities – i.e. all the money the pension fund has received – may be divided into technical provisions, financial derivatives and loans. Together they amount to the pay-outs that a pension is obligated to make.

- **Assets**

  The money received by pension funds is invested in in different types of assets:

  - public listed equities, consisting of publicly traded stocks of large corporations;
  - corporate bonds that are issued by a corporation to raise money to expand its business;
  - government bonds that are issued by a national government to fund public services, goods or infrastructure;
  - private equity, consisting of investments in unlisted companies, ranging from venture capital investments in start-ups, to mezzanine financing for established companies aiming for a trade sale or public listing, to buy-outs of public companies;[5]
  - commodities, which are natural resources or derivatives of natural resources, like food, energy and metals;
  - hedge funds, which are aggressively managed portfolios of investments that use advanced investment strategies such as leveraged, long, short and derivative positions in both domestic and international markets with the goal of generating high returns;[6]
  - real estate, consisting of a wide range of products including home ownership for individuals, direct investments in rental properties and office and commercial space for institutional investors, publicly traded equities of real estate investment trusts, and fixed-income securities based on home-loans or other mortgages.

In 2014, the average asset allocation of the seven largest pension markets in the world (Australia, Canada, Japan, Netherlands, Switzerland, United Kingdom, United States) was: 42.3% equities, 30.6% bonds, 2.3% cash and 24.8% other assets (including property and other alternative).[7]

There is a growing recognition among pension funds and an increasing demand from stakeholders that Environmental, Social and Governance (ESG) issues are a fundamental part of assessing the value and performance of investments. Pension funds' investor views and motivations to adopt responsible investment strategies are embedded in five main interrelated categories: fiduciary duty, risk management, financial performance, expectations from stakeholders and universal ownership. The pension fund has a fiduciary duty that involves creating optimal value for the participant of the fund. Value in this case includes both financial return and ESG considerations.[8]

ESG factors are an important dimension of investment expectations and ESG factors should be part of a pension funds' overall expectations for their fund's performance. Furthermore, pension funds should make sure that the asset managers they hire act in line with the pension funds' risk management procedures as well as with participants expectations. As a vast majority of pension funds have outsourced management tasks to external providers and to create a shared vision of ESG risks and possibilities, the pension fund should communicate a coherent set of ESG expectations to agents acting on their behalf.[9] Pension funds as 'universal owners' are investors in a broad cross-section of the economy and they should use their position as capital providers to deny notorious polluters and human rights offenders access to capital, stimulate the large majority of companies to invest in sustainable development and production methods and grant smaller, truly innovative companies easier access to capital.[10]

Many investors refer to the Principles for Responsible Investment (PRI) or the UN Global Compact. Financial institutions that adhere to the PRI or the UN Global Compact inherently already make an intentional statement on ESG issues. This shows their awareness on the subject and intention to apply responsible (financing) policies to their investment decisions. Being a member of the PRI or adhering to the Global Compact, however, is not a guarantee for sustainable practices.

### 1.3.5 Asset managers

Often, large financial institutions do not only provide capital to companies and governments by means of corporate loans or investments and investment banking. They may also have one or more subsidiaries which are involved in asset management. These asset management subsidiaries invest in shares, companies and government bonds along with other types of investments. They do so with monies from private investors, pension funds, policy holders and other clients. For these asset management activities, financial institutions don't always apply the same policy that they apply for their lending and investment banking.

This is to some extent due to the differences between saving and investing. Savers cannot choose where their money is invested, but on the other hand they enjoy the security of a relatively fixed savings interest rate and, in many countries, a government guarantee on savings deposits.

However, investors are generally more at risk, although their returns may be higher. Moreover, investors are free to make choices as to how their money is invested. For example, they can choose from the range of investment funds the financial institution offers them (often including funds marketed as 'sustainable'). Therefore, some financial institutions do not see the need to apply a 'responsible investment policy' to all asset management activities: it is reasoned that the investing clients who consider this important will opt for the sustainable funds the financial institution offers.

The Fair Finance Guide International primarily focuses on customers with a current or savings account at a bank. For them, the main concern is which policy the bank applies for its lending and other financial services. The policy that the subsidiaries of the bank apply for asset management is not directly relevant for these savers, because the money of savers is not managed by these asset management subsidiaries. Yet, many savers do consider the policy of the financial institution for asset management to be important. As clients, they expect that their bank operates responsibly in all these aspects, including in its asset management, regardless of whether this concerns investments with their own savings.

For customers of a financial institution's asset management division (i.e. investors), insurance customers or customers who commission the financial institution to invest for them (i.e. *private banking* customers), an assessment of the policy for asset management is also important.

The Fair Finance Guide International believes that financial institutions may also be expected to act in a responsible way regarding their activities in the field of asset management, and therefore, the policy of the financial institutions towards asset management is also assessed. In making the decision to include an assessment of the policy for asset management, it was of great importance for the Fair Finance Guide International that most financial institutions can play a role in creating a just and sustainable world through their asset management activities. As asset managers, they can choose which investments to offer to their clients. Such choices may have consequences for the availability of capital for companies and governments.

## 1.4 Assessment of policies

### 1.4.1 Themes

The Fair Finance Guide International has chosen to assess the policies that the investigated financial institutions apply to the investment categories corporate credits, project finance, investments made on its own account and asset management for third parties, with regard to cross-cutting themes and sector themes. The cross-cutting themes entail the main international sustainability issues that are paramount to the work of the organisations behind the Fair Finance Guide International and are relevant to all or most of the industrial sectors a financial institution may finance or invest in:

- Animal welfare
- Climate change
- Corruption
- Gender equality
- Health
- Human rights
- Labour rights
- Nature
- Tax

The Fair Finance Guide International believes that all financial institutions should have a clear policy on all these cross-cutting themes.

When a financial institution invests in, or grants financial services to, companies in certain sensitive industrial sectors (i.e. those where sustainability problems are particularly likely), then the financial institution should also have specific policies for these sectors. Presently, the Fair Finance Guide International has selected the following sector themes:

- Arms
- Financial sector
- Fisheries
- Food
- Forestry
- Housing and real estate
- Manufacturing industry
- Mining
- Oil and gas
- Power generation

Besides the themes that merely asses a financial institution's investment and finance policy and the expectations therein regarding the investee companies' and/or clients' behaviour, Fair Finance Guide International has also developed themes that only assess the internal operations of a financial institution. These themes are indirectly related to the investment decisions made by the financial institutions and consist of:

- Consumer protection
- Financial inclusion
- Remuneration
- Transparency and accountability

The coalitions that are collaborating in the Fair Finance Guide International network have agreed that a number of themes will be used by all coalitions to assess the selected financial institutions' policies.[vii] The other themes can be added by coalitions depending on the public debate, the priorities and objectives of the organizations within the coalition.

In the future, new themes may be included in this methodology. For all these themes, the policies of the financial institutions are compared to national and international norms, standards and initiatives for sustainable development and Corporate Social Responsibility, and to other criteria that are considered important in the opinion of the organisations that make up the Fair Finance Guide International.

### 1.4.2 Contents of policy

To underpin and structure the comparison of financial institutions' policies, this methodology describes the selected cross-cutting themes (in Chapter 2), sector themes (in Chapter 3) and operational themes (Chapter 4). Each selected theme is dealt with in a separate section, beginning with "*What is at stake?"*, a description of the sustainability issues involved. This is followed by an overview of applicable and widely supported international standards, such as declarations, conventions, guidelines, certification schemes, and codes of conduct (*"International standards and initiatives"*)**.** Next, the elements a financial institution should include in its policy for investments and financial services are described ("*Assessment elements"*).

These elements are formulated as *principles*. Principles can be applied by the financial institutions in various ways, for new and existing investments and financial services. For example, the principles can be included by the financial institutions in the conditions for new loans and be applied as selection criteria for new investments and financial services. For existing loans and investments they can be applied as a guideline for engagement activities and for agreements on improvements with the companies in which the financial institution has existing investments. Based on these principles, financial institutions could ultimately decide to terminate an investment relation.

[vii] These are: Climate change, Corruption, Human rights, Labour rights, Nature, Tax, Transparency and accountability, and Arms.

The Fair Finance Guide International does not comment on the way financial institutions should apply the principles to their investments and financial services, but does expect that they explain their method of working in their policies. The financial institution would *inter alia* have to indicate what the principles mean for various types of investments and financial services. If the financial institution only establishes a certain condition for a specific type of investment or for certain financial services, it is difficult to claim that the financial institution applies a principle. The Fair Finance Guide International believes that principles need to have a meaningful link to the activities or products of a company for all types of investments in companies and all financial services to companies.

Multiple principles consider certain activities to be ‘unacceptable’ and are worded as: “Activity X is unacceptable”. The Fair Finance Guide International strongly disapproves these activities. However, because the Fair Finance Guide International does not comment on the way financial institutions should apply their investment principles, the word ‘unacceptable’ should not be read as ‘excluded’. In other words it should not be considered as the expectation that companies involved in these activities should be excluded immediately. Fair Finance Guide is aware of the different instruments and steps financial institutions could take for implementing such principles. Financial institutions could for example start a clearly defined engagement process to convince the company invested in to stop the unacceptable activity and mention a clear timeframe in which this needs to happen. Fair Finance Guide International does expect a policy that claims to consider certain activities as undesirable or unacceptable includes these steps and is convincing on the implementation. A policy that mentions limitations or exceptions, such as a threshold on revenues companies earn with involvement in the undesired acitivity, can receive a score for this element. On the other hand it could also lose scores if Fair Finance Guide, having certain expectations of the companies it should apply to, has decided to add elements about these limitations.

When the financial institution explains its method of working, its objectives are of importance, because the financial institution can use them to indicate how and when it will ensure that the entire investing portfolio and all granted financial services comply with the principles formulated in its policy. This is mainly important if the existing portfolio of the financial institution does not yet entirely comply with the policy. Fair Finance Guide International expects that such objectives have been included in the policy and investigates this *inter alia* by means of case studies.

In its assessment of the policies of financial institutions, Fair Finance Guide International does hardly assess the way the financial institution takes decisions on its investments and financial services, but focuses on the underlying *principles* or *expectations* of the financial institution with regard to the companies it finances or invests in. In the tables with assessment elements for each cross-cutting theme and each sector theme, these principles or expectations are introduced as “the following elements are crucial for a policy regarding the companies a financial institution invests in.”

The assessment methodology of the Fair Finance Guide International does, however, include four *operational* themes. The assessment elements included in these themes largely concern the business operations of the financial institution, including the way decisions on investments and financial services are taken.

And as a further exception to the rule that the Fair Finance Guide International focuses on the underlying principles of policies and not on implementation, a few elements have been included in the assessment tables for other cross-cutting and sector themes that concern operational activities of the financial institution. These assessment elements are introduced separately as “the following elements are crucial for a policy regarding the financial institution's internal operations.”

### 1.4.3 Scope of policy

To assess the investment policies of financial institutions, the Fair Finance Guide has developed a number of assessment elements which are deemed crucial for a good policy on the themes which are evaluated by the Fair Finance Guide. These elements are described and explained in Chapter 2, Chapter 3 and Chapter 4. The Fair Finance Guide policy assessment then verifies whether these elements are included in the public policy documents of a financial institution.

However, not only the content, but also the scope of the financial institution's policy document is of importance. Policy documents sometimes cover only a small share of all investments made by the financial institution. This can especially be the case with large international banking groups, which often have a multiple subsidiaries in different countries which offer different products and services to various client groups. As the Fair Finance Guide aims to assess the policies which are applied across the entire banking group, including all subsidiaries, the scope of policy documents is integrated in the assessment methodology.

Experience with the assessment of investment and credit policies learns that there are generally four situations in which a financial institution's policies might insufficiently cover the full scope of all investments made, and financial services offered, by the financial institution:

- The policy is not adopted by all subsidiaries within the financial institution;
- The policy is not applied to all categories of investments and financial services;
- The policy is not applied to all countries the financial institution invests in; and
- The policy is not applied to all activities of a company (e.g. only if the investment is earmarked for certain activities).

The last two situations are found less often and are not always mentioned in the policies themselves. The third is also, if mentioned, often part of risk assessment procedures. As these are difficult to trace back to policies and in order to simplify the scoring model, the Fair Finance Guide does not take those situations into account further.

In order to take into account the first two situations in its scoring methodology, the Fair Finance Guide has selected four categories of investments (or financial services) that are considered relevant for most financial institutions the Fair Finance Guide investigates. This selection is based on the description of the various types of financial institutions in section 1.3 and on research done on the scope of the investment and credit policies of financial institutions. To assess the scope of the policies of a financial institution, the Fair Finance Guide considers the following categories of investments (or financial services):

- **Corporate credits**: loans and other forms of credits provided by a financial institution to (listed and unlisted) companies, which allow the company to finance short-term expenses and/or long-term investments. Corporate credits usually carry an interest rate and are secured by specific assets (as in the case of mortgage loans) or by the entire balance sheet of the company. This category also includes the underwriting of share and bond issuances, but does not include loans and credits to private customers.
- **Project finance**: a specific form of corporate credits to finance infrastructure or industrial projects, whereby the loan is secured by the projected cash flows of the project rather than by the balance sheet(s) of its sponsor(s).
- **Investments for own account**: investments in (sovereign and corporate) bonds, shares and other types of securities for the account of the financial institution, listed on the financial institution's balance sheet.

- **Asset management for the account of third parties**: the management of a client's investments in all types of securities by a financial services company, such as an investment bank, a private bank, an investment manager or an asset manager. These investments are usually not listed on the balance sheet of the financial institution. This category includes all funds and mandates which are managed actively or passively for clients, as well as all forms of investment advice offered to clients. The definition of asset management used here does not apply to trading platforms managed by financial institutions, where financial institutions do not provide investment services.

Fair Finance Guide International integrates other investment categories into the scoring model of the sector theme Housing and Real estate and the operational themes Consumer protection and Financial inclusion. These are explained in the themes separately. For each financial institution, the Fair Finance Guide researcher determines which of the investment categories are relevant, as (one or more subsidiaries of) the financial institution is actively making this type of investments or is offering these financial services. How this assessment of relevant categories is made, is explained further in section 1.4.5.

### 1.4.4 Scoring system

For every theme, the score of each financial institution is based on the proportion of elements included in the policy, corrected for the relevant investment categories that the policy is applied to. In its scoring system, the Fair Finance Guide therefore takes into account both the *contents* and the *scope* of the policies of the financial institution.

This is done in the following way. For each principle included in the policies of the financial institution that corresponds with an element of the Fair Finance Guide methodology a *contents score* of 1.0 is assigned.

This contents score is multiplied by the *scope of the policy*, expressed as a percentage. If the financial institution does not clarify the scope of this policy, it is assumed that 50% of the financial institution's activities are covered. For each investment category to which the financial institution explicitly applies the policy, 12.5% is added. If the policy is applied to all investment categories, the scope is therefore 100% and the *total score* for each element can reach 1.0 as maximum.

The above is based on the assumption that the financial institution is active in all four investment categories mentioned in section 1.4.3. If the financial institution is active in only three, two or one of these investment categories, the basic scope percentage remains 50%. For each investment category to which the policy is explicitly applied, then respectively 16.67%, 25% or 50% is added to the scope. When a financial institution applies its policies to all investment categories it is active in, the scope will therefore always be 100%.

In some situations the content score will not be multiplied by the scope of the policy and thus will be limited to 50%:

- The researcher assessing the policy finds a clear commitment but the scope is unclear;
- the text of the policy is vague, but still quite credible according to the researcher assessing the policy; and

- the financial institution has taken an initiative[viii] which supports the principle but which is not formally stated in the finance and investment policy and does not cover a whole investment category.

Fair Finance Guide acknowledges that smaller and locally oriented banks could be less exposed to sustainability risks than financial institutions targeting midsize, large and companies, operating in countries all over the world and with long, complicated supply chains. Therefore it is possible to handle situations differently when a financial institution, in a credible way, can demonstrate that an element is not really relevant. If, due to its business orientation or geographical presence, the financial institution is not exposed to the risk of breaching the principle specified in the assessment element, the element can be considered "not applicable”. Elements can also be considered fulfilled if effective national legislation is in place in the countries where all the companies, that a bank lends to or invests in, are active.

The scores for all elements included in a theme are added together and then divided by the total number of elements. This results in the *final score* for a theme. Fair Finance Guide coalitions are free to present the outcome as a single number between 0 and 10 or as a percentage. Each coalition can also attach qualifications of their choice, such as sufficient, good or excellent, to this score.

### 1.4.5 Determining relevancy

Fair Finance Guide International determines relevancy and materiality of the type of investments according to the following considerations:

- **Private mortgages**

  Fair Finance Guide International focuses on the financial relationships between companies and financial institutions. A category like private mortgages therefore initially falls outside the scope of Fair Finance Guide International, but for some banks it is an important asset. However, the sustainability challenges within many of the selected themes are not directly relevant for this type of investment. Fair Finance Guide International only integrates this type of investment into the scoring model of the sector theme Housing and Real estate and the operational themes Consumer protection and Financial inclusion.

- **Asset management**

  A difficulty in assessing the policies on asset management for third parties is that they hardly ever share a common policy on all their asset management activities. This is due to the organisation's structure. Financial institutions often have several subsidiaries in the field of asset management, and these could all have their own policies. Often they even use a specific policy for a specific product, like an investment fund or a mandate. In this way there are hundreds or thousands of different investment products that all may have their own specific policy.

[viii] Such initiatives could be, among others: setting up or participating in meetings with business clients or other companies and stakeholders; participating in a round table or something similar; signing an investor statement; engaging in collective dialogue; and publishing brochures describing the issues and suggesting solutions or steps.

Furthermore, not all types of asset management are assessed, because in consultation with Dutch financial institutions (March 2011) it has been established that they are not all relevant. The asset management subsidiaries of financial institutions are not always free to choose whether to provide capital to certain companies or governments. And sometimes it is not possible for these asset management companies to deploy instruments on ‘responsible investment’. Based on the following criteria it has been determined whether the various asset management activities are included in the assessment:

- Will capital be at the disposal of companies or governments as a result of this kind of asset management?
- Will the bank have freedom of choice/responsibility regarding the granting of this kind of asset management (possibly under certain conditions)?
- Is the bank able to use sustainable investment instruments when granting this financial service?

Based on these criteria, the Fair Finance Guide International has decided to include the following types of asset management in the assessment of the scope of the policies of each financial institution:

- The financial institution’s own investment funds: investment funds that have been assembled and offered by the financial institution itself to private and institutional investors;
- Private banking: all forms of discretionary management of private investors’ money, meaning both direct investments in shares and bonds regarding other parties' investment funds;
- External Mandates: investments in shares and bonds or in investment funds, using institutional investors’ money (i.e. pension funds, insurance companies);
- Internal client relations: investments in shares and bonds or in investment funds, using internal clients' money. This includes insurance premiums.[ix]

Types of asset management not included in the assessment of the scope of the policy are:

- Advice regarding private banking;
- Trading platforms where clients may invest by themselves in shares, bonds and investment funds of other parties (execution only services);
- Taking charge of shares for private or institutional investors.

Finally, in order to be able to take into account the scope of responsible investment policies for asset management, the Fair Finance Guide International looks at the total number of assets that are managed and that have their own responsible investment policy. If a financial institution has different asset management policies the policy that applies to the highest part of assets under management will be assessed. If this is the case for other investment types as well, the same rule applies.

[ix] Investments using insurance premiums are on the parent company’s balance sheet and they therefore fall within the scope of investments using the bank’s own resources and are not part of asset management on behalf of third parties. Since these investments are not part of the banking branch of the financial institution and therefore may not be financed with saver’s money, they are categorized as asset management.

- **Sectors**

  General policies often apply to all investments and financial services, while sector policies merely concern a limited part of the investments of a financial institution. Therefore, principles that have been included in the financial institution's sector policy and only apply to companies active in a specific sector do not count for the assessment of the cross-cutting themes.

  If the financial institution can prove or explicitly and publicly states that it is not involved with companies operating in a certain sector, the financial institution is not expected to have a policy for this sector. In that case the contents score is not multiplied with scores for the type of investment this applies to, but given the notification "not applicable" (n.a.). If it is the case for all types of investments researched, the sector as a whole can receive this qualification.

  If a financial institution does not make an explicit statement that it is not active in a particular sector, the decision for applying n.a. can be made based on information about the portfolio in the annual report(s) of the financial institution and its subsidiaries. For defining the maximum level of investments in one of the investment categories (threshold), Fair Finance Guide International uses the breakdown of the portfolio:

  - If the sector is explicitly mentioned in the breakdown of its, for example, corporate credit portfolio, apply n.a. when less than 0.2% and a maximum of EUR 1 million of total corporate credits is lend to that specific sector.
  - If the sector is mentioned together with other sectors (e.g. public administration, defence and social security), then apply n.a. when this is together less than 1.0% and a maximum of EUR 5 million of total corporate credits.
  - If the sector is not mentioned explicitly, but only overarching and overlapping sectors and definitions such as manufacturing, other, or 'building materials and construction', do not apply n.a.
  - The same applies to the other types of investment (project finance, investments own account and asset management for third parties).
  - If there is not enough information available regarding the portfolio, the qualification n.a. cannot be given.

  Note that the companies operating in a certain sector do not only include primary producers. Also trade, transport, warehousing, processing, and finally, retail companies are part of the supply chain and therefore belong to this sector.

### 1.4.6 Documents assessed

Fair Finance Guide International expects that the policy of the financial institution, or at least a summary of it, is made public, for example through its website or in the annual report. The name or the topic of the policy document is not relevant, for example elements on labour rights can be included in a human rights policy.

Sometimes a financial institution makes a statement about a decision considering a certain issue in a newsletter or press release. In the first year after publication Fair Finance Guide International will consider this as a valid source of information, but it also expects the financial institution to integrate the decisions in its investments policy – as the employees who will make the decisions about investments will not take all these newsletters, brochures etc. into account. When updating the policy review Fair Finance Guide International will check whether the principle is part of the general policy documents. If a financial institution published a principle in newsletters or documents in the period before the previous update was published (2015), and has not integrated this principle into policy documents, it will not be considered as a principle for this year's policy update.

### 1.4.7 Scoring standards and initiatives

When assessing the policies of financial institutions, not only the policies that the financial institution has developed independently but also the broader standards and initiatives adopted or endorsed by the financial institutions are taken into consideration. These include sustainability initiatives which can be undersigned by financial institutions, such as the Equator Principles, and the Principles for Responsible Investment. Undersigning these initiatives represents an obligation to apply certain sustainability criteria on the investments and financial services of a financial institution.

Other initiatives and standards, such as the IFC Performance Standards and the accompanying Environmental, Health and Safety Guidelines, UN Global Compact, the UN Guiding Principles for Business and Human Rights, the OECD Guidelines for Multinational Enterprises and others, cannot be undersigned by financial institutions or its does not include the obligation to apply the criteria to its investments and financial services. But financial institutions can adopt these initiatives, by stating explicitly that they apply in full the procedures and criteria described in these documents when taking financing and investment decisions.

The adoption by a financial institution of such sustainability initiatives and standards, thus means that it could adhere to one or more of the principles (elements) defined in the assessment methodology, although the element as such is not mentioned in the policy documents of the financial institution itself. Financial institutions that have signed a standard or initiative and make clear that it is applied to the financing of and investment in companies, therefore receive a content score for each element that is clearly included in that particular standard. This score will be multiplied with the scope score for each investment category to which the policy is explicitly applied as well.

## 1.5 Case Studies

Fair Finance Guide International hopes to stimulate a process that leads to ever increasing tightening of the norms used by financial institutions (*race to the top*) in social, environmental and economic fields and to enhance the constructive role these financial institutions can play in creating a just and sustainable world. Naturally, the policy the financial institution has formulated is only one of the necessary steps.

Equally important is the issue whether the financial institutions themselves, when making decisions on their investments, in practice comply with the norms recorded in widely supported international standards, such as conventions, guidelines, certifications and codes of conduct. Therefore, in case studies Fair Finance Guide International investigates the operational practices, strategies and instruments and evaluates the investments and financial services of the researched financial institutions. The outcomes of these studies are reported on the websites as well and linked to the themes involved, but do not lead to a downgrade of the policy assessment score.

# Chapter 2 Cross-cutting themes

## 2.1 Animal welfare

### 2.1.1 What is at stake?

Animals are – along with people – sentient beings that deserve respect and protection. Based on this fundamental principle, animal protection organisations advocate measures to protect the welfare of animals. And if successful, animal welfare advocates can look forward to growing interest from society and the corporate world. In a protocol of the Amsterdam Treaty (1997), and its successor the Lisbon Treaty (2007), the European Union officially recognizes animals as sentient beings. The plea of animal protection organisations increasingly resonates among European civilians, as the Eurobarometer shows. To this effect, governments also pay increasing attention to this topic. In other countries outside Europe, animal welfare is also increasingly becoming an issue for the public. The World Animal Protection's plea for a Universal Declaration on Animal Welfare (UDAW) is signed by people all over the world.

The welfare of animals is also important for the wellbeing and the health of large groups of people. About one billion people depend on the health and productivity of the animals they work with for their income, food and clothing. To this effect, the UN Food and Agriculture Organisation (FAO) has decided to pay more explicit attention to animal welfare. According to the FAO, animal welfare is related to food security, food safety, health, sustainability, working conditions, rural developments, gender equality and social justice.[11]

Mainly in (intensive) livestock farming, the welfare of animals is often under pressure because animals are often kept in circumstances that are not suitable for the species and are not worthy of the animal's dignity. In intensive livestock farming (including the conventional pig, poultry, meat cattle, rabbit, goat and dairy livestock farming and fish in intensive aquaculture), animals are kept in high concentrations and often undergo un-anaesthetised surgery (cutting tails, clipping beaks, teeth filing, dehorning). Animals hardly have the opportunity to behave naturally (grazing, free ranging, grubbing). Intensive livestock farming is also characterised by a farming system that is not ground bound: cattle feed is delivered to the farm and manure has to be removed from it. So the system is characterised by the absence of a natural cycle and shifting the consequences of environmental pollution (eutrophication and acidification) towards society.

Due to changed consumption patterns in emerging markets (such as the BRICS-countries: Brazil, Russia, India, China and South Africa) the worldwide demand for livestock products - meat, dairy products, eggs - is increasing. To meet this demand in a way that pays attention to animal welfare standards is a major challenge and not only because ignoring animal welfare leads to increasing health risks for the population due to the possible rapid spread of diseases.[12] In the current situation, animals are already living without basic needs, such as adequate space. Intensification in livestock production under current circumstances will therefore almost certainly result in the suffering of even more animals.[13]

Also, transport over long distances and controlling the conditions prior to and during slaughtering of the animals deserves attention. During transportation animals have to deal with the following circumstances: bad ventilation, too little space, shortage of food and water, bad treatment during the loading and unloading procedures, bad health conditions of the animals prior to the transport and exposure to germs. Animal transport may therefore result in exhaustion, dehydration, anxiety, injury, diseases and may even lead to the death of the animals involved.

Outside the livestock industry, animal welfare standards are also of importance in industries like the pharmaceutical and cosmetics industries that often make use of laboratory animals. The international social and political debate is increasingly based on the 3-Rs-alternative to animal testing: Replacement, Reduction and Refinement. Furthermore, in the recreation industry, animals are deployed for sports and entertainment - equestrianism, circuses and zoos - and there are companies that keep animals for their fur. By now, breeding and trading pets has also grown into an important industry in many countries. And finally, in pleasure pursuits such as hunting, hunting tourism, and in fighting pests and fishing, the welfare of animals is often at stake.

The International Finance Corporation (IFC) states in its 2014 Good Practice Note that businesses "that address or enhance animal welfare are likely to win or retain a competitive advantage in the global marketplace by: [14]

- reducing costs due to improved human-animal relationships and other welfare benefits, which can lead to increased productivity;
- realizing growing market opportunities for food produced in animal welfare-credentialed systems; and/or
- becoming the producer of choice for retailers and consumers concerned with animal health and welfare, food safety and quality, human health, and the environment."

The investment policy of financial institutions should take the welfare of animals into account when investing in or financing of companies in all the industries mentioned. This moral obligation follows from recognizing animals as sentient beings capable of feeling pain and stress, as humans do. Furthermore, neglecting the welfare of animals may also have consequences in the fields of health and the environment. When developing policies in this respect, financial institutions can make use of the international standards described in the following section.

### 2.1.2 International standards

Standards concerning animal welfare differ in scope and application. We can differentiate between generally accepted principles, international standards, EU legislation and national law.

- **In general**

  Wellbeing is the quality of life of animals as experienced by the animals. The Five Freedoms are often taken as a principle for preparing standards on animal welfare. This concept arose from the Brambell Report published in Great Britain in 1965 and the following request of the UK Minister of Agriculture to the Farm Animal Welfare Council (FAWC) to revise the *Welfare Codes* for cattle, pigs, domestic fowls and turkeys. This has led to the following list of five freedoms that can be applied to all animals.

  An animal has to live free from:

  1. Hunger, thirst and malnutrition (direct access to fresh water and solid food to stay healthy and strong).
  2. Any thermal or physical discomfort (having suitable, comfortable housing that offers tranquillity).
  3. Pain, injury and diseases (by means of prevention or diagnosing and treating quickly).
  4. Fear and chronic stress (by circumstances that avoid suffering and stress).
  5. The denial of natural (species-specific) behaviour (by supplying sufficient space, sufficient and proper provisions and company from animals of the same species).

In a protocol at the Amsterdam Treaty (1997), the European Union officially recognises animals as sentient beings and indicates that European civilians and institutions in the field of agriculture, fishery and science have to take the welfare of animals into account. This protocol has also been fully included as Article 6b in the successor of the *Amsterdam Treaty*, the Lisbon Treaty (2007), which came into force on December 1, 2009.

The World Trade Organization (WTO) Agreement on the Application of Sanitary and Phytosanitary Measures (SPS Agreement) encourages its members to base their sanitary measures on international standards, guidelines and recommendations, where they exist. The OIE World Organisation for Animal Health is the WTO reference organisation for standards relating to animal health and zoonoses. The OIE has published two codes (Terrestrial and Aquatic) and two manuals (Terrestrial and Aquatic) as the principle reference for WTO members.

The OIE (World Organisation for Animal Health) standards are intended to safeguard the hygienic safety in the trade in animals and animal products. The *Terrestrial Animal Health Code 2015* and the *Aquatic Animal Health Code 2015* respectively aim to assure the sanitary safety of international trade in terrestrial animals and aquatic animals, and their products. The codes concern animal health but also include recommendations for animal welfare, mainly with respect to transport, slaughter, and killing animals to prevent the spread of diseases and stray animals.

The Terrestrial Animal Health Code was first published in 1968 and the Aquatic Animal Health Code was introduced to the public in 1995. The codes traditionally addressed animal health and zoonoses, but they have, in recent years, expanded to cover animal welfare, animal production food safety, consistent with the expanded mandate of the OIE which is 'to improve animal health worldwide'.

The Manual of Diagnostic Tests and Vaccines for Terrestrial Animals and the Manual of Diagnostic Tests for Aquatic Animals provide a harmonised approach to disease diagnosis by describing internationally agreed laboratory diagnostic techniques. These manuals were published in 1989 and in 1995, respectively.

The OIE regularly updates its international standards as new scientific information comes to light, following its established transparent and democratic procedures. The only pathway for adoption of a standard is via approval of the World Assembly of Delegates meeting in May each year at the OIE General Assembly.

The Welfare Quality Project has resulted in various practical measuring instruments for assessing animal welfare. The five freedoms are also included in this project and in the measuring instruments. In addition, clear minimum animal welfare standards in general, as well as the ones focused on a few animal groups, have been drafted.

The ISO 26000 guidelines, published in November 2010, recognises the importance of animal welfare in the principle 'Ethical behaviour'. The underlying values - fairness, justice and integrity - imply caring for people, animals and the environment. Ethical behaviour can be encouraged by respecting the welfare of animals, including providing effective resolutions if the organisation affects the life and the existence of animals.[15]

*This leads to assessment elements 1, 13 and 14.*

- **Protection of genetic material**

The Cartagena Protocol to the Convention on Biological Diversity has drafted provisions with respect to the use of GMOs and the identification of GMOs in the processing chain. For example, trade in living modified organisms is prohibited unless approval of the importing country has been obtained. Also, signatories of the protocol themselves have to comply with precautionary measures for the production and the use of GMOs. Because the technology and the knowledge of GMOs is still developing, the GMO standards in the Cartagena Protocol are also constantly developing.

The Bonn Guidelines are recognized as a useful first step in the implementation of relevant provisions of the UN Convention on Biological Diversity (CBD) and are meant to assist stakeholders in developing access to genetic resources and benefit-sharing strategies.

According to Fair Finance Guide International, companies should at least comply with the relevant guidelines, but preferably refrain from involvement in living genetically modified organisms.

*This leads to assessment element 4*

- **Laboratory animals**

The European Convention for the protection of vertebrate animals for experimental and other scientific purposes concerns the use of animals in experiments. Directive 2010/63/EU revising Directive 86/609/EEC on the protection of animals used for scientific purposes was adopted on 22 September 2010. There is also European legislation for the housing and caring of laboratory animals and there are rules for assessing animal testing. There is a European ban on conducting animal testing to test cosmetics and the use of great apes for testing purposes.

In the Netherlands, the Law on Animal testing applies to laboratory animals.

*This leads to assessment element 2.*

When planning and conducting animal experiments, one can strive for improvement as described by the researchers, W.M.S. Russel and R.L. Burch, in their 3R-strategy, *Replacement, Reduction and Refinement*:[16]

- Replacement: laboratory animals can be replaced by non-animal alternatives.
- Reduction: the number of animals used, is reduced as much as possible.
- Refinement: Discomfort (pain/inconvenience) of laboratory animals is prevented as much as possible, both prior to, as well as after testing.

European Union Directive 2010/63/EU of 2010 “spells out the principle of the ‘Three Rs’ and makes it a firm legal requirement. The principles of Replacement, Reduction and Refinement must be considered systematically at all times when animals are used for scientific purposes in the EU”.[17]

In April 2008, research institutions in the Netherlands have signed the Animal Experiments Openness Codes in which they oblige themselves “to systematically shift to Replacement, Reduction, and Refinement of animal testing (3 Rs)”.

*This leads to assessment element 3.*

- **Farm animals**

In Europe, several conventions have been adopted to protect farm animals. In the European Convention for the Protection of Animals kept for Farming Purposes (adopted in 1976 and amended in 1992) minimum guidelines for livestock farming with respect to welfare have been included. In addition, conventions on transport (adopted in 1968 and amended in 2003) and on slaughter have been adopted. These conventions are further elaborated in specific rules for certain animal species and topics. The Council Directive concerning the protection of animals applies to all farm animals (98/58EG). Furthermore, there are specific rules for the transport of animals, stunning and killing of animals, housing and care for animals and animal health. In the long run, some abuses in intensive livestock farming are phased out, such as keeping calves in crates (prohibited since 2007), hens in battery cages (prohibited as of 2012) and keeping sows in feeding cubicles (prohibited as of 2013).

In 2016, over 70% of the world's farm animals are factory farmed.[18] The Business Benchmark on Farm Animal Welfare 2015 is an annual Benchmark of food companies' performance on farm animal welfare, supported by the civil society organizations (CSOs) World Animal Protection and Compassion in World Farming and private equity firm Coller Capital. "It's aims are (p.5):

- To provide investors with the information they need to understand the business implications of farm animal welfare for the companies in which they are invested.
- To provide investors, governments, academics, CSOs, consumers and other stakeholders with an independent, impartial and reliable assessment of individual company efforts to adopt higher farm animal welfare standards and practices.
- To provide guidance to companies interested in improving their management and reporting on farm animal welfare issues.

The benchmark assesses food producers, restaurants and bars and food retailers and wholesalers, covering the entire food supply chain".

A similar initiative of Coller Capital is Farm Animal Investment Risk and Return (FAIRR). The initiative aims at improving investor's understanding of risks related to factory farming. In its report Factory Farming: Assessing Investment Risks, FAIRR states that "animal factory farming is exposed to at least twenty-eight environmental, social and governance issues that could significantly damage financial value over the short or long-term. Many of these risks are currently hidden from investors".[19] Investors can join FAIRR and opt for committing to its three principles:[20]

- Principle 1: We will consider farm animal welfare in our investment decision-making process;
- Principle 2: We will consider including farm animal welfare in our investment monitoring;
- Principle 3: We will support transparency on farm animal welfare issues by the entities in which we invest.

In organic farming, norms for animal welfare are also included. With respect to organic farming, the *International Federation of Organic Agricultural Movements* (IFOAM) has developed the Norms for Organic Production and Processing.Norms for Organic Production and Processing. These consist of the IFOAM Basic Standards for Organic Production and Processing and the corresponding Accreditation Criteria. All producers worldwide adhering to the IFOAM norms are included in the Organic Guarantee SystemOrganic Guarantee System. In 2007, the new EU regulation for labelling of organic production methods (regulation nr. 834/2007) came into force.

In February 2008, the *Sustainable Agriculture Network* (SAN) published the Sustainable Agriculture Standards.Sustainable Agriculture Standards. The norms are based on guidelines of, among others, the United Nations, the European Union and the International Labour Organization and are endorsed by the *Rainforest Alliance*. The standards comprise of ten criteria for sustainable agriculture (on dealing with wild animals on farms).

Intensive livestock farming often fails to meet the Five Freedoms criteria. The Dutch Society for the Protection of Animals therefore introduced the Better Life Label for animal products in 2008, specifically aimed at so-called intermediate segments (farming systems that fall between the intensive and the organic livestock farming and concern being animal friendly). This star system (the more stars, the better the animal welfare) has been developed to challenge the corporate world to improve the wellbeing of animals in livestock farming. The quality requirements that the Dutch Society for the Protection of Animals has set for wellbeing are recorded in agreements with suppliers of meat and are checked by independent bodies.

*This leads to assessment elements 6, 7 and 8.*

- **Fish**

In contrast to other major forms of livestock agriculture, there is a paucity of scientific information on the welfare of fish raised under intensive aquacultural conditions. This reflects an adherence to the belief that these animals have not evolved the salient biological characteristics that are hypothesised to permit sentience. However, there is scientific evidence for the existence of sentience in fish, and in particular, their ability to experience pain, fear and psychological stress. Anatomical, pharmacological and behavioural data suggest that affective states of pain, fear and stress are likely to be experienced by fish in similar ways as in tetrapods. This means that fish have the capacity to suffer, and that welfare considerations for farmed fish should take these states of pain into account.[21]

Globally, there are several initiatives to promote and certify animal welfare issues related to fishing and aquaculture.

The Global Aquaculture Alliance (GAA), which is an initiative from American companies, has developed a system of certification with regard to fish farms. Today there are standards for both shrimp, tilapia and Channel catfish cultivation, as well as for the fish processing industries. In this system animal welfare criteria have been laid down. This applies to pain and anxiety mainly, since science has shown that fish may experience such sensations as well.

Other issues related to fish and fisheries are discussed in section 3.3.

*This leads to assessment element 9.*

- **Other animals**

The European Convention for the Protection of Pet Animals contains rules on the protection of pet animals.

In Europe, there are rules for the use of traps to catch animals for their fur. There is a ban on the trade in cat and dog fur and an import ban on seal fur.

As of January 2013 it is illegal in the Netherlands to keep animals for their fur or to kill them if the only objective is using their fur . According to the law people who keep animals for their fur must put an end to these activities before 2024.[22] In the United Kingdom keeping animals for their fur was already prohibited in 2000.[23] In the Netherlands, the Flora and Fauna Law is in force. It contains rules on hunting, the authorised means of hunting and damage control.

*This leads to assessment element 5.*

According to animal protection organisations, circuses and dolphinariums that deploy animals for entertainment purposes do not meet the Five Freedoms criteria. Animals are unable to show their natural behaviour and suffer fear and chronic stress. Moreover, often use is made of animals that were captured in the wild. According to animal protection organisations, such activities are unacceptable.[24]

Various countries have implemented legislation to prohibit the use of (wild) animals in circuses. Below, we will limit the information to the countries currently represented in the Fair Finance Guide International:

- As of March 2014, Belgium has a national ban on the use of wild animals in circuses.
- In France there is a national ban on the use of certain wild animals in circuses, by means of a positive list, effective from 18 March 2011. Several cities prohibit circuses that use wild animals.
- At the end of 2014, the Dutch government presented a draft law or ban on the prohibition of the use of wild animals in circuses, effective from September 15, 2015.
- In Sweden there is a national ban on the use of certain species of wild animals in circuses, effective from 1994. There is a ban on the use of monkeys, carnivores, rhinos, giraffes, kangaroos, hippos, seals, birds of prey, ostriches, crocodiles and deer.
- In Brazil, a national ban on the use of wild animals in circuses was adopted in 2009 by the Commission of Education and Culture. In several districts there is a ban on the use of all kinds of animals in circuses.

*This leads to assessment element 11*

Compared to circuses and dolphinariums, zoos have more objectives, such as conservation, research, shelter and education. Also, there is more attention paid to housing that meets the needs of the animal. For zoos, it should be of great importance that the housing and care is arranged in such a way that the animals can show their natural behaviour. In Europe, there are rules for keeping wild animals in zoos.

*This leads to assessment element 10.*

- **Transport**

The Dutch Parliament has spoken out in favour of putting an end to the long distance transport (more than 8 hours) of cattle for slaughter. A majority in Parliament supported Marianne Thieme's motion, which asked the government to investigate possibilities for limiting the duration of transports that leave from the Netherlands. The government should also look into the possibilities of restricting the duration of transport within the Netherlands.[25]

This is not the first time that the Dutch Parliament has expressed such demands. Also the European Parliament has voiced her wishes to set limits to the maximum duration of livestock transport, especially with regard to the transport of cattle for slaughter. Several Dutch Governments have subsequently urged the EU to set duration limits. Until today these requests have been to no avail as there is no majority for this measure among the Member States of the European Union.[26]

*This leads to assessment element 12.*

- **Procurement and supply chains**

  Companies are often part of long production chains. They can monitor one another and question how they respect local and national legislation and international norms on climate change. The requirements that companies set for their suppliers can be included in contractual agreements. The importance of this also recognised in the OECD Guidelines for Multinational Enterprises since its revision in 2011.

  Also the ISO 26000 guideline recognises the importance of supply chain responsibility, because “the impacts of an organization's decisions or activities can be greatly affected by its relationships with other organizations.” A companies’ sphere of influence includes relationships within and beyond an organization’s supply chain.[27]

  *This leads to assessment element 13 and 14.*

### 2.1.3 Assessment elements

Financial institutions can influence the welfare of animals if they finance or invest in industries where animals are used, captured and/or (re)produced, such as fishery, livestock farming, the pharmaceutical industry and other companies with an animal testing facility like the cosmetics industry, the recreation industry, the fur industry and pet breeding.

The following elements are crucial for a policy regarding the companies a financial institution invests in or finances:

1. Companies respect the Five Freedoms of animals.
2. Animal testing for testing cosmetics is unacceptable.
3. Requirements are set for the use of laboratory animals for manufacturing medical products in order to limit animal suffering and the number of animals used as much as possible (the so-called 3R-strategy). The companies involved are open, transparent and actively and demonstrably look for alternatives to animal testing.
4. Genetic modification of animals and the production of derived products is unacceptable.
5. Capturing and/or keeping animals for their skin/fur and manufacturing, trading and selling (derived) fur products is unacceptable.
6. Extremely restricted housing methods including calves in crates, hens in battery cages and sows in feeding cubicles are unacceptable.
7. Companies shift from intensive livestock farming to animal friendly production.
8. Livestock farming companies are certified according to the certification schemes criteria that include animal welfare requirements (such as organic, free range, environment label, Better Life label).
9. Fish farms are certified according to the certification schemes criteria that include animal welfare, including the avoidance of stress, anxiety or pain, quality feed and spacious facilities.
10. Companies guarantee the welfare of animals with activities that have an educational and nature protection objective and in which wild animals are involved in any way (such as zoos).

11. Entertainment activities in which wild animals are involved (including circuses, dolphinariums, fighting games with animals and shows and exhibitions with animals) are unacceptable.
12. Companies reduce the time limit of animal transport to a maximum of 8 hours.
13. Companies integrate animal welfare criteria into their procurement and operational policies.
14. Companies include clauses on the compliance with criteria on animal welfare in their contracts with subcontractors and suppliers.

## 2.2 Climate change

### 2.2.1 What is at stake?

The climate on earth is changing: globally the temperature is increasing. Due to this, ecosystems are changing and societies are at risk of being struck by floods and cyclones. This process is a direct result of human activities that increase the concentration of greenhouse gases in the atmosphere.

Already in 2006 the influential research report Stern Review on the Economics of Climate Change, predicted that the concentration of greenhouse gases in the atmosphere would be twice as much in 2035 (550 parts $CO_2$ per million) as it was before the industrial revolution, and that it would cause a rise in temperature of 2°C. This will have an enormous impact on the world, especially when you realise that today it is only 5°C warmer than it was during the last ice age, which ended about 10,000 years ago.[28]

The leading authority on this topic, the Intergovernmental Panel on Climate Change (IPCC) publishing quite regularly scientific research on climate change concluded in its its Fifth Assessment Report that the average global temperature increase since the mid twentieth century has been largely caused by the observed increase of greenhouse gases concentrations (such as carbon dioxide, methane, nitrogen oxide and some other gases), released by human activity. The main greenhouse gas is carbon dioxide ($CO_2$), which is released with the combustion of fossil fuels. The fifth IPCC-report states that it is *highly likely* that human activities have caused more than 50% of the noticed temperature increase between 1951 and 2010.[29]

Recent climate changes have had widespread impacts on human and natural systems: [30]

- The globally average land an ocean surface temperature show a warming of 0.85 °C over the period 1880 to 2012;
- Glaciers have continued to shrink, spring snow cover had continued to decrease, and permafrost temperatures have increased;
- Over the period 1901 to 2010, global mean sea level rose by 19 cm.

The IPCC has also presented four scenarios (Representative Concentration Pathways, RCPs) for future climate change in the fifth report. The best case scenario is that the rise in temperature will stay under 2°C, but it is still very likely that: [31]

- heat waves will occur more often and last longer:
- extreme precipitation events will become more intense and frequent in many regions;
- the ocean will continue to warm and acidify; and
- global mean sea level to rise - in ranges of 26 to 82 cm.

These developments not only lead to extraordinary and unprecedented risks for the global environment, but can also have profound and disastrous consequences for mankind economically, socially, as well as for human health. The *Stern Review* as well as IPCC reports and reports of other organisations predict the following climate change consequences:[32]

- Melting glaciers will cause a steep increase in the average water level of some rivers. The availability of water will increase in some areas, while elsewhere drought and a lack of drinking water will occur.
- Of all plant and animal species globally, 15 to 40% are at risk of extinction if the average temperature increases by more than 2°C. This will lead to a rapid degradation of ecosystems and the acidification of oceans, which in turn will have major consequences for marine ecosystems. Global climate belts will shift, with drastic consequences for flora and fauna.
- Climate change undermines food security. While the global food production will increase with local temperatures that increase between 1-2°C, it in turn will decrease as soon as the temperature increases further. Higher frequencies of periods of drought, floods, hurricanes and heat waves will also affect the production of local crops; mainly in areas close to the equator that already produce little food.
- Climate change will increase the risk of peat fires worldwide, leading to substantial and sustained $CO_2$ emissions as peat fires can smoulder for years and have the highest $CO_2$ production of all fires. Haze caused by peat fires also causes serious long-term health problems.[33]
- Coastal areas will be exposed to increased risks by the increasing sea level and coastal erosion. Not only coral reefs and *wetlands* are at risk, but also huge cities in developed and developing countries. The melting or breaking down of ice floes will ultimately threaten the residential areas of 1 in every 20 people.
- If the existing climate change scenario becomes a reality, almost half the world's population will be living in areas of high water stress by 2030. This is including between 75 million and 250 million people in Africa. Furthermore, water scarcity in some arid and semi-arid places will cause the displacement of between 24 million and 700 million people.[34]
- Poor communities are even more vulnerable because their adaptability is limited and because they are more dependent for their livelihood on climate sensitive provisions such as local water and food supplies.[35]
- The climate changes will influence the health of millions of people, mainly of those who have difficulty in adapting. Those groups already physically weakened by malnutrition are the most vulnerable for the expected increase in heat waves, floods, storms, fires and droughts, metabolic diseases and parasitic diseases such as malaria or dengue.[36]

Depending on future developments, according to the IPCC in the 21st century, globally the temperature will increase between 0.3°C and 4.8°C on average. This will increase the likelihood of severe, pervasive and irreversible impacts for people and ecosystems. To reduce climate change risks both mitigation and adaptation are necessary. In order to reduce the global temperature rise to 2°C it is necessary that the average emission should be reduced with 40 to 70% by 2050 compared to the level of emissions in 2010.[37]

While in 2020 the energy related emission of $CO_2$ should not exceed 32 Gigatonnes, in 2014 global energy related emissions already reached 32.2 Gt. According to the IEA, the objective not to increase the average temperature on earth by more than 2°C will be very difficult to realise if $CO_2$-emissions keep increasing at this speed.[38]

During the [21st session of the Conference of the Parties (COP21)] in Paris in 2015, 195 nations decided to aim for keeping the global temperature rise preferably below 1.5 °C, in 2100. The agreement also recognized that much greater emission reduction efforts will be required than submitted by the countries in their intended nationally determined contributions.[39] Calculations of Climate Action Tracker confirm that these country plans would result in around 2.7 °C of warming in 2100. If only a few countries would increase their reduction targets, this would already reduce the 1.5 °C gap by 20-34%.[40]

Companies in various industries will be confronted with climate change consequences and risks in the economic, social and health care fields. Climate change itself brings new legislation on mitigating emissions, but at the same time new opportunities and innovations. Companies that produce, process, transport, or use fossil fuels in large volumes will first be required to consider changing their *business model*. Buying out or compensating $CO_2$-emission should only be considered as a last resort. There are projects for $CO_2$-storage and $CO_2$-removal from the atmosphere, but research by SinksWatch and other organisations shows that a lot of these types of projects do not lead to concrete greenhouse gas reductions and moreover may have negative consequences for other sustainability aspects.

The Sendai Framework for Disaster Risk Reduction 2015-2030, adopted in March 2015, considers climate change as one of the drivers of disaster risk. Investing in disaster reduction for economic, social, cultural, and environmental resilience of persons, communities and countries and the environment, is one of the four top priorities. . "Such measures are cost effective and instrumental to save lives and prevent and reduce losses", the United Nations report argues.[41]

To be able to adapt to the consequences of climate change, large scale investments are required, mainly in developing countries. In a report published in November 2014 Oxfam International argues that financial goals set in earlier agreements will not be sufficient to close the finance gap. It will be vital to negotiate a finance package that recognises the true scale of the climate change challenge, while remaining responsive to the needs and specific circumstances in given countries. For example, for sub-Saharan Africa alone by 2050 an additional USD 60 billion is needed per annum for a 2°C-consistent international agreement on finance for climate change adaptation.[42] To win the battle against climate change, the most $CO_2$-intensive industries - energy, construction, food, heavy industry and transport - have to change structurally.[43]

According to conservative estimations by Eurodad and other civil society organizations (CSOs), developing countries' climate finance needs are thought to be between USD 27 to USD 66 billion per year by 2030 for adaptation and USD 177 billion per year for mitigation'. Global civil society organizations (137) call upon financial institutions to play a major role in financing climate adaptation. [44]

Integrating climate change in financial decision making has evolved from being seen as part of 'extra-financial criteria' or ESG-criteria to a potential major financial risk threatening the business models of companies, and financial stability in general. In April 2015, the G20 finance ministers have requested the Financial Stability Board (FSB) to review how the financial sector can take account of climate-related issues. The FSB proposed to create an industry-led Task Force on Climate-Related Financial Disclosures to identify which financial assets will lose value due to climate related risks and to "develop voluntary, consistent climate-related financial disclosures for use by companies in providing information to lenders, insurers, investors and other stakeholders".[45] UNEP has initiated an Inquiry into the Design of a Sustainable Financial System (UNEP Inquiry) and has published its final report in October 2015. It presents policy options to deliver a step change in the financial system's effectiveness in mobilizing capital towards a green and inclusive economy that also addresses climate change risks.[46]

For financial institutions, the challenge is to deal with climate change risks in a proactive way, by measuring and reporting the carbon footprint of their financial portfolios and presenting strategies to make their portfolio's consistent with the internationally agreed 2°C limit of temperature increase. This also requires having a strategy for the transition to a low-carbon economy, including the switch from using fossil fuel to renewable energy sources. Besides encouraging companies in which they invest to measure, disclose and reduce emissions, financial institutions should also phase-out investment in and finance of activities with unacceptable high emissions. Therefore, Fair Finance Guide pays special attention to the characteristics of the commitments made by financial institutions in their so-called divestment policies. Furthermore an investment and finance policy regarding climate change should include criteria for compensation, adaptation and lobbying against governmental climate change regulation.

When developing policies in this respect, financial institutions can make use of the international standards described below.

### 2.2.2 International standards

The most important international standards concerning climate change are summed up below.

- **Setting measurable reduction objectives**

  The climate problem is global by nature and therefore requires an internationally coordinated set of answers. The world community is working on this and has two main international conventions on climate change since the nineties:

  - The 1992 UN Framework Convention on Climate Change (UNFCCC) formulates global objectives and principles and asks all member states to annually report their emission of greenhouse gases. Virtually all countries in the world take part in the UNFCCC, including the United States.
  - The 1997 Kyoto Protocol is based on the principles and objectives of the UNFCCC and establishes objectives and timelines for industrialised countries to limit their emissions. On average, the Kyoto Protocol demands an emission reduction (during the period 2008-2012) of 5.2% of the greenhouse gases in comparison to the level of 1990.

  Although the Kyoto Protocol is a first step in reducing global emissions of greenhouse gases, scientists argue that the established reduction objectives are far too low to halt climate change, let alone undo it. To limit the global temperature increase to 2 to 2.4°C - which will in any way lead to drastic social, economic, and environmental problems - according to the IPCC, the annual global emission of greenhouse gases should be 40 to 70% lower in 2050 than in the year 2010, on average.[47]

  Several United Nations climate change conferences were held with the aim to reach a new agreement which could replace the Kyoto Protocol, but this has not been achieved until 2015. The 21st session of the Conference of the Parties (COP21) in Paris in 2015 is considered a historic agreement as it brings 195 nations together in the main aim to keep the global temperature rise below 2 °C, or preferably even below 1,5 °C, in 2100. The agreement also noted that the estimated aggregate greenhouse gas emission levels in 2025 and 2030 resulting from the intended nationally determined contributions do not fall within 2 ˚C scenarios and recognized that much greater emission reduction efforts will be required. Countries therefore have to submit updated climate plans every five years that are no less ambitious than existing ones.[48]

  *This leads to assessment elements 1, 4 and 10.*

- **Measuring and reporting greenhouse gas emissions**

  In order to be able to set reduction objectives it is necessary to first measure and report on emissions. Globally, the standards of the Greenhouse Gas Protocol (GHG Protocol) are the most used standards to measure and manage greenhouse gas emissions. Amongst others the GHG Protocol has developed a standard for the emissions of products and the corporate value chain. The GHG Protocol is consistent with the IPCC guidelines for reporting $CO_2$-emissions.

  Some financial institutions have developed initiatives to standardise and encourage the measurement of carbon footprints by banks and investors.

  The Carbon Disclosure Project (CDP) is a coalition of institutional investors that asks the world's largest companies to release their annual emissions and other information on climate change. The CDP also acts as the Secretariat for the Climate Disclosure Standards Board (CDSB), established at the annual meeting of the World Economic Forum in 2007, as a response to the increased demand for standardised reporting guidelines for financial information related to climate change. Its Climate Change Reporting Framework was launched in September 2010 and last edited in 2012.

  The Portfolio Decarbonisation Coalition (PDC), by the UNEP, CDP and the UNEP Finance Initiative, also strives to encourage financial markets to drive economic decarbonisation.

  The Montréal Carbon Pledge, launched in September 2014, commits investors to measure and publicly disclose the carbon footprint of their investment portfolios on an annual basis.

  The Asset Owners Disclosure Project (AODP) encourages asset managers to be transparent about the $CO_2$-emissionsand identifying climate change risks concerning their portfolios. The 2015 survey found that nearly half of the 232 did nothing to protect investments from climate change risk. [49]

  *This leads to assessment elements 2, 3 and 9.*

- **Transition to a low-carbon economy**

  The third working group that contributed to the IPCC's Fifth Assessment Report, published in 2014, focused on mitigating, or avoiding, climate change, and showed that the world must significantly reduce its reliance on fossil fuels in the coming decades. The IPCC projected that over the next two decades (2010 to 2029), annual investment in conventional fossil fuel technologies for electricity supply sector would decline, with a median projected rate of decline being around 20%. At the same time, annual investment in low-carbon electricity supply (including renewable energy, nuclear power and electricity generation with carbon capture and storage) is projected to rise by 100% compared to 2010 on the same median basis. [50]

  There are various initiatives within the corporate world and the financial industry to make agreements and to exchange experiences on stimulating the transition to a low-carbon economy:

  - UNEP FI's Climate Change Working Group (CCWG);
  - the Investor Network on Climate Risk (INCR);
  - the Institutional Investors Group on Climate Change (IIGCC);
  - the Global Business Leadership Platform on Climate Change; and
  - the Global Roundtable on Climate Change.

Shifting towards a low-carbon economy will mean in practice to move away from high emission generating activities to low emission activities. From this perspective, activities such as extracting fossil fuels and using them for power generation are unacceptable (even if they would have operational carbon capture and storage technology). An investment and finance policy that makes such statements is more credible if it is not followed by all kinds of exceptions and thresholds.

*This leads to assessment elements 11, 12, 13, 14, 15, 16, 17 and 18.*

- **Biomass for energy generation**

While biofuels can be helpful in reducing greenhouse gas reduction targets, the material for biofuel production (biomass) also carries along some disadvantages. As such, biomass production typically takes place on cropland that was already used for growing food or feed. Most often, soy farmers do thus not deforest themselves. Agricultural production, since it is still necessary, is consequently displaced leading to conversion of forests or natural grasslands to croplands elsewhere.

This process can be recognized as Indirect Land Use Change (ILUC). ILUC is crucially important to assess the sustainability impacts of for instance soy expansion and crops for biofuels in general. ILUC especially concerns first generation biofuels, as second- or third generation biofuels can also be made from waste of feedstock used for food or feed, and hence do not directly require cropland. Hence, no real positive climate impact can be achieved through first-generation biofuels.[51]

In 2010, the Steering Board of the Roundtable on Sustainable Biomaterials (RSB) approved Version 2 of the principles and criteria for sustainable biomass production, after three years of consultation with stakeholders. The RSB offers Global Standards that apply to any type of feedstock worldwide and EU-RED Standards that apply to feedstock entering the EU market and comply with the EU Renewable Energy Directive regarding land-use and GHG criteria.[52] The global RSB Principles are: [53]

1. Biofuel operations shall follow all applicable laws and regulations.
2. Sustainable biofuel operations shall be planned, implemented, and continuously improved through an open, transparent, and consultative impact assessment and management process and an economic viability analysis.
3. Biofuels shall contribute to climate change mitigation by significantly reducing lifecycle GHG emissions as compared to fossil fuels.
4. Biofuel operations shall not violate human rights or labor rights, and shall promote decent work and the well-being of workers.
5. In regions of poverty, biofuel operations shall contribute to the social and economic development of local, rural and indigenous people and communities.
6. Biofuel operations shall ensure the human right to adequate food and improve food security in food insecure regions.
7. Biofuel operations shall avoid negative impacts on biodiversity, ecosystems, and conservation values.
8. Biofuel operations shall implement practices that seek to reverse soil degradation and/or maintain soil health.
9. Biofuel operations shall maintain or enhance the quality and quantity of surface and ground water resources, and respect prior formal or customary water rights.
10. Air pollution from biofuel operations shall be minimized along the supply chain.
11. The use of technologies in biofuel operations shall seek to maximize production efficiency and social and environmental performance, and minimize the risk of damages to the environment and people.
12. Biofuel operations shall respect land rights and land use rights.

The RSB standards are accompanied by a set of guidelines such as the RSB-Impact Assessment Guidelines and the RSB-Screening Tool.[54]

The European Parliament intends to reduce the $CO^2$ emissions of the cultivation for biofuels. By 2020, the EU aims to have 10% of the transport fuel of every EU country coming from renewable sources such as biofuels. Fuel suppliers are also required to reduce the greenhouse gas intensity of the EU fuel mix by 6% by 2020 in comparison to 2010.[55]

*This leads to assessment element 19.*

- **$CO_2$-compensation**

The Gold Standard for $CO_2$-compensating investments - developed by the WWF - identifies investments that do contribute to sustainable development. The Gold Standard contains strict criteria for certification. These criteria are maintained by means of monitoring, reporting and processes of verification.

$CO_2$-compensating investments are used by airlines, for example. Many airlines have their own $CO_2$-compensation price calculation for a *green* seat. The amount of $CO_2$-emissions is often wrongly estimated, and not all the greenhouse gases that are emitted during flights are mentioned. [56]

*This leads to assessment element 20.*

- **Lobbying practices**

Companies in heavy industries (such as steel company Arcelor Mittal) have successfully lobbied against European intervention in the emission market. Arcelor Mittals top executive wrote a letter to the European Commission in 2006, in which he threatened to close down the factories if the Commission would put restrictions on the issuing of carbon credits. [57] In April 2013 the steel and chemical industries' branch organizations wrote a letter to the European Parliament, stating that the emission market should not be changed as this would only increase the costs and aggravate the competition between the industries in Europe.[58] The Parliament then voted for a proposal, in which the plans had been diluted, as late as July 2013. Similarly, on the 9th of October 2014, TATA Steel wrote a letter to the Dutch government, urging it to consider the competitive position of the company, as well as its role as employer, in the discussions with the European Commission about European climate and energy policy.

In 2012 Sandbag published a report with an overview of Belgian companies that benefit from the *loopholes* in Europe's Emissions Trading System (ETS). According to Sandbag these are all companies that (through their branch organisations) actively lobby against improving the climate policy.[59]

*This leads to assessment element 21.*

- **Procurement and supply chains**

Companies are often part of long production chains. They can monitor one another and question how they respect local and national legislation and international norms on climate change. The requirements that companies set for their suppliers can be included in contractual agreements. The importance of this also recognised in the OECD Guidelines for Multinational Enterprises since its revision in 2011.

Also the ISO 26000 guideline recognises the importance of supply chain responsibility, because "the impacts of an organization's decisions or activities can be greatly affected by its relationships with other organizations." A companies' sphere of influence includes relationships within and beyond an organization's supply chain.[60]

*This leads to assessment element 22 and 23.*

### 2.2.3 Assessment elements

Investments that take place today determine the $CO_2$-intensity of all future activities. Therefore, it is crucial that strict reduction objectives are set now and companies are stimulated to emit less $CO_2$. Being important financiers of energy projects, financial institutions can play a leading role in shifting investments to a less $CO_2$-intensive economy. Hereby, financial institutions should apply $CO_2$-avoiding standards in line with the UN-objectives, in order to limit global warming.

The following elements are crucial for a policy regarding the financial institution's internal operations:

1. For its own direct and indirect greenhouse gas emissions, the financial institution establishes measurable reduction objectives that contribute to limiting the maximum global temperature increase of 1.5°C.
2. For its financed greenhouse gas emissions, i.e. the emissions of the companies in which the financial institution invests, the financial institution discloses its share of the emissions of the energy companies[x] and projects it invests in.
3. For its financed greenhouse gas emissions, the financial institution discloses its share of all the companies and projects it invests in.
4. For its financed greenhouse gas emissions the financial institution establishes measurable reduction objectives that contribute to limiting the maximum global temperature increase of 1.5°C.
5. The policy has a maximum threshold[xi] of 30% restricting finance of and investment in coal-fired power generation and coal mining.
6. The policy has a maximum threshold of 30% restricting finance of and investment in fossil fuel-fired power generation and extracting oil and gas .
7. The policy has a maximum threshold of 0% restricting finance of and investment in coal-fired power generation and coal mining.
8. The policy has a maximum threshold of 0% restricting finance of and investment in fossil fuel-fired power generation and extracting oil and gas.

The following elements are crucial for a policy regarding the companies a financial institution invests in or finances:

9. Companies disclose their direct and indirect greenhouse gas emissions.
10. Companies reduce their direct and indirect greenhouse gas emissions.
11. Companies switch from using fossil fuels to renewable energy sources.
12. Unabated coal-fired power generation (i.e. without operational carbon capture and storage) is unacceptable.
13. Coal-fired power generation is unacceptable.
14. Fossil fuel-fired power generation is unacceptable.

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[x] Companies active in the energy sector include the power generation companies itself ánd the companies involved in producing the sources of energy, including coal, oil, gas, solar, wind, geothermal, nuclear, hydro, biomass, and tidal.

[xi] Examples of thresholds mentioned in policies: revenues, electricity generated, installed capacity, and utilized capacity.

15. Coal mining is unacceptable.
16. Extracting oil from tar sands is unacceptable.
17. Extracting oil and gas is unacceptable.
18. Conversion of peatland and high-carbon stocks for agricultural development is unacceptable.
19. The production of biomaterials complies with the 12 principles of the Roundtable on Sustainable Biomaterials (RSB).
20. $CO_2$-compensation is certified according to the Gold Standard.
21. Companies do not participate in lobbying (attempting to influence decisions made by regulators) aimed at weakening climate policy.
22. Companies integrate climate change criteria in their procurement and operational policies.
23. Companies include clauses on the compliance with criteria on climate change in their contracts with subcontractors and suppliers.

## 2.3 Corruption

### 2.3.1 What is at stake?

Corruption has significant negative consequences on the political, social and environmental fields. On the political field, corruption forms a large obstacle when developing the rule of law. Government representatives lose their legitimacy when many abuse their office for personal gain. It also undermines the faith of the people in the political system, which leads to frustration and apathy. It clears the way for leaders, whether chosen democratically or not, to appropriate national assets for themselves without supervision. And if corruption is the norm, honest and capable civilians will leave the country.[61]

In a lot of countries, the tax system suffers from corrupt practices. It lowers tax revenues and limits the possibilities of the government to meet its obligations.[62] Corruption also has negative economic consequences. It leads to capital flight and to the expenditures of scarce public funds to unprofitable prestige projects, instead of to more necessary types of infrastructure such as schools, hospitals and drinking water supplies. It also hinders the development of markets and disturbs free competition. In addition, corruption leads to large scale plundering of natural resources, such as wood, gemstones and minerals. Large scale, strongly polluting projects are given free rein in a climate of corruption and they often mean public money ends up in private hands.[63]

The Transparency International (TI) Corruption Perceptions Index shows that corruption mainly occurs in southern, poorer countries. But TI emphasises that for corruption, two parties are involved, the payer as well as the receiver of the bribes. According to the TI Bribe Payers Index, companies from China and Russia are most inclined to pay bribes, but also companies from OECD-countries like Italy and France have a poor reputation in that respect. According to TI, corruption occurs mostly in the construction industry (including public works and real estate).[64] In the Netherlands, the Dutch National Bank (DNB) investigated corruption risks at Dutch banks and insurers. The DNB found out that corruption risks, both connected to internal operations as to clients and investee companies, are sufficiently identified, but are not adequately taken care of.[65]

Lobbying practices can have similar effects as corruption. Although lobbying as such cannot be regarded as corruption per se, sometimes lobbyists will go as far in striving to influence legislators and regulators that it could almost be considered as corruption. The influence of the corporate world on the development of international norms is often large and forms an important ground for legislation being behind on certain fields. On the one hand, public institutions have formulated clear rules for their employees to which they must comply in order to prevent bribery and influence. On the other hand the participation of social and commercial organisations in the decision-making process is far from transparent. Since the mid-nineties, Canada and the US have mainly been active in providing more clarity in this respect. That is why in these countries, organisations are now obliged to register when they participate in the decision-making process. Organisations that register themselves can therefore make it clear that they work in a transparent and legitimate way.

One can expect from responsibly operating financial institutions that they do not deliberately assist clients in moneylaundering and paying or receiving bribes, and that they do not accept or pay bribes themselves. Moreover, financial institutions have the responsibility to only grant financial services to companies that do not engage in corruption and negatively influencing the development of international norms. When developing policies on corruption, financial institutions can make use of the international standards described below.

### 2.3.2 International standards

The most important international standards in the field of corruption are summarized below.

- **Anti-money laundering and beneficial ownership**

  In December 2014 the European Parliament and Council agreed listing the ultimate owners of companies on central public registers. In May 2015 the EU's Anti-Money Laundering Directive (AMLD) is revised according to this vote in EU Directive 2015/849 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing. Any company and trust registered in an EU member state is required to provide information about its beneficial owner including: name, month and year of birth, nationality, country of residence and as well as the nature and extent of the beneficial interest held.

  The international standard in the field of money laundering is set by the Financial Action Task Force (FATF), a work group that was established by the OECD in 1989. The FATF comprises of 36 members, mostly governments of OECD-member states. The FATF aims to promote the successful implementation of legal, regulatory and operational procedures for combating money laundering, the financing of terrorists and other associated threats to the integrity of the international financial system.

  The FATF has developed a set of Forty Recommendations that are considered as the international standards for the combating of money laundering. These recommendations offer guidelines and tools to governments and financial institutions to fight money laundering and criminal earnings at all levels. The recommendations have been published in 1990, but have been revised in 1996, 2001, 2003 and 2012. The FATF has also published several Interpretative Notes, which provide guidance on the application of the guidelines in practice.

  Recommendation 12 deals with *Politically Exposed Persons (PEPs)* and their relatives. When dealing with PEPs, financial institutions are required to have enhanced due diligence and risk-management systems in place.

The *Forty Recommendations* have been taken over by numerous international institutions, such as the World Bank and the International Monetary Fund (IMF), as well as by the governments of many countries. In May 2015, the European Union processed the latest edition of the Forty Recommendations in the Fourth European Money Laundering Directive.

In a 2011 report, The Puppet Masters, the World Bank's Stolen Asset Recovery Initiative developed a guidance on how to prevent corruption via the hiding of stolen assets.[66] The document "examines the links between large-scale corruption by high-level public officials and the concealment of stolen assets through opaque shell companies, foundations, and trusts".[67] The initiative urges all financial institutions to "collect beneficial ownership information about the company and continue to monitor whether this information is accurate".[68]

The Wolfsberg Group, a group of 11 international banks that undertake a lot of activities in the field of *private banking* (banking for rich private clients), published a revised edition of the Wolfsberg Anti-Money Laundering Principles on Private Banking in May 2012. In these principles, the FATF-recommendations are further elaborated on asset management and private banking. In addition, the Wolfsberg Group has also published various other principles in the field of money laundering, financing of terrorism and corruption.

*This leads to assessment element 2, 3, 4 and 7.*

- **Corruption and bribery**

The UN Convention against Corruption (UNCAC) contains minimum standards in order to prevent corruption as well as money laundering. It explains what states would have to do to prevent, and bring to trial, corruption and money laundering and provides recommendations on international cooperation and recovery of capital. As of December 2015, the convention is signed by 140 nations. In 2011, these nations have agreed to establish a Mechanism for the Review of Implementation of the UNCAC.

The main international standard with respect to fighting international corruption is the Convention on Combating Bribery of Foreign Public Officials in International Business Transactions of the OECD, which came into force in February 1999. The convention obliges countries to make paying bribes to foreign public officials a criminal offence. As of January 2016, thirty-four OECD member countries and seven other countries have ratified the convention, which obliges them to implement this convention in their national legislation.

The OECD Guidelines for Multinational Enterprises state: “Enterprises should not, directly or indirectly, offer, promise, give, or demand a bribe or other undue advantage to obtain or retain business or other improper advantage.” This is further elaborated upon in seven detailed guidelines.

In December 2004, TI published the Business Principles for Countering Bribery, a framework that can help companies to draft an effective anti-corruption policy. The new edition of 2013, stresses the importance of implementing principles and policies in anti-bribery programmes. Although a lot of large companies have an anti-corruption policy, the implementation often leaves a lot to be desired and in practice bribes are still regularly being paid. To help companies with the implementation of their anti-corruption policy, TI provides the Corruption Fighters’ Tool Kit.

The Wolfsberg Anti-Corruption Guidance (revised, extended and renamed version of the Wolfsberg Statement against Corruption) which includes measures with which financial institutions can prevent corruption in their own organisation and protect themselves against abuse of its institution for corruption.

*This leads to assessment elements 1, 8 and 9.*

- **Lobby practices**

  Non-transparent lobbying practices can have similar effects as corruption. Various national and regional initiatives try to provide insight into the interests of organisations within legislation processes. The most recent initiative comes from the European Commission, which has drafted a voluntary register for interest representatives in 2008 within the framework of the European Transparency Initiative. In this way, they aim to inform the public which general or specific interests groups influence the decision-making process of the European institutions and what budget they have. Therefore, organisations that register can make it clear that they work in a transparent and legitimate way. By registering, they promise to comply with the code of conduct. Because the register is voluntary, social organisations call upon the European Commission to adopt the example set by the United States and Canada where registration is obliged. The 2014 revision of the interinstitutional agreement of the European Union did not yet entail mandatory registration.

  *This leads to assessment element 6 and 10.*

- **Procurement and supply chains**

  Companies are often part of long production chains. They can monitor one another and question how they respect local and national legislation and international norms on tax and corruption. The requirements that companies set for their suppliers can be included in contractual agreements. The importance of this also recognised in the OECD Guidelines for Multinational Enterprises since its revision in 2011.

  Also the ISO 26000 guideline recognises the importance of supply chain responsibility, because "the impacts of an organization's decisions or activities can be greatly affected by its relationships with other organizations." A companies' sphere of influence includes relationships within and beyond an organization's supply chain.[69]

  *This leads to assessment elements 11 and 12.*

### 2.3.3 Assessment elements

For financial institutions, the issue corruption is relevant in two ways. Firstly, international financial institutions are multinational corporations themselves and therefore can be expected to be to have a policy to prevent corruption.

Secondly, corruption is an issues on which financial institutions should assess all the companies they invest in or finance, even if the financial institution does not actively cooperate with the corrupt payments made by the company.

The following elements are crucial for a policy regarding the financial institution's internal operations:

1. Offering, promising, giving and requiring, either directly or indirectly, bribes and other undue advantages in order to acquire and to maintain assignments and other undue advantages, is unacceptable.
2. The financial institution complies with the FATF recommendations.
3. The financial institution complies with the Wolfsberg Principles.
4. The financial institution properly verifies the ultimate beneficial owner(s) of a company.
5. The financial institution applies additional safeguards when it enters into indirect or direct business relations with Politically Exposed Persons.
6. The financial institution reports onits participation in the decision-making processes of international norms and legislation (lobby practices).

The following elements are crucial for a policy regarding the companies a financial institution invests in or finances:

7. Companies publicly disclose their ultimate beneficial owner or owners including full name, date of birth, nationality, jurisdiction of residence, number and categories of shares, and if applicable the proportion of shareholding or control.
8. Offering, promising, giving and requiring, either directly or indirectly, bribes and other undue advantages in order to acquire and to maintain assignments and other undue advantages, is unacceptable.
9. Companies have a management system which results in immediate actions if suspicions arise that employees or suppliers are guilty of corruption.
10. Companies report on their participation in the decision-making processes of international norms and legislation (lobby practices).
11. Companies integrate criteria on corruption in their procurement policies and operational policies.
12. Companies include clauses on the compliance with criteria on corruption in their contracts with subcontractors and suppliers.

## 2.4 Gender equality

### 2.4.1 What is at stake?

Gender refers to socially constructed identities, attributes and roles for women and men.[70] In short, gender determines what is expected, allowed and valued in a women or a man in a given context. Gender equality refers to the equal rights, responsibilities and opportunities of women and men.[71] Equality between women and men requires that women's and men's rights, responsibilities and opportunities do not depend on whether they are born male or female.

While gender inequalities also affect men and transgender and can be applied at the level of sexual orientation (lesbian, gay, bisexual), this chapter focuses on women. Women's constructed identities, attributes and role in society have traditionally lead to a gender imbalance of power between men and women. To offer some examples:

- The poverty rates of women are higher than men's poverty rate, particularly when it comes to non-partnered women with children in developed and developing regions and older women in one-person households;[72]
- Women have less access to formal financial systems: at global level only 47 per cent of women had an individual or joint account at a formal financial institution compared to 55 per cent of men. In developing countries, women's percentage stands at 37 and men's percentage stands at 46;[73]

- The legal rights of women remain unequal compared to the rights of men in most of the countries: a World Bank's study concluded that in 90 per cent of 143 countries studied there was at least one legal difference restricting women's economic opportunities and their ability to be economically independent;[74]
- Women are less likely to be employed than men and, when they are employed, they are more likely to be in vulnerable jobs;[75]
- Gender-based violence affects at least 30% of women globally.[76] Moreover, in the majority of countries, less than half of the women who experienced violence sought help.[77]
- Women remain a minority among senior managers in the private sector: the share of women in senior- and middle-level management positions is far below 50 per cent, according to UN Statistics Division. In addition, only about half of the 59 countries with data on women in managerial positions have shares of 30 per cent or above**;**[78]
- Fewer than 4 per cent of CEOs in the world's 500 leading corporations were women in 2014. Moreover, the gender composition of executive boards of private companies is far from parity according to UN Statistics Division.[79]

As explained in section 2.6 companies can impact the entire range of human rights issues and have an enormous impact on people's lives and the communities in which they operate. For example, the fact that one billion women still do not use or have access to the financial system[80] creates difficulties for women in collecting and saving income, makes women more vulnerable to economic and social exclusion and challenges the effective enjoyment of women's economic, social and cultural rights. Moreover, the highly visible inequality between women and men in leadership and decision-making positions both, in public and private institutions, may infringe the right to equal access to public services and the right to equality and non-discrimination. These situations serve also to illustrate how business activities may create or exacerbate gender inequality.

The different impacts that business have on gender equality between men and women have been largely documented by civil society organisations (CSOs).[81] In addition, there is overwhelming evidence that an ostensibly gender-neutral approach to policy making renders invisible important gender issues, and marginalizes women's experience.[82] Among the recommendations, many CSOs suggest adopting a gender mainstreaming approach.[83] Gender mainstreaming refers to the process of assessing the implications for women and men of any planned action, including legislation, policies or programmes, in all areas and at all levels.[84] This is a strategy for making women's as well as men's concerns and experiences an integral dimension of the design, implementation, monitoring and evaluation of policies and programmes. For example, if as a result of large-scale infrastructure project a community is resettled, a gender mainstreaming approach would require companies to consider whether such resettlement may have different, disproportionate or unforeseen impacts on women and men including familial responsibilities, economic opportunities and child care.

While gender mainstreaming for policies and programmes is a specific focus of international organizations, such as the ILO and the UN, this is not the case for the private sector. For businesses, considering gender specific impact is still an emerging issue. A review of corporate governance codes and guidelines, including responsible investment and finance policies - undertaken by Profundo on the occasion of this theme - concludes that corporate governance codes and guidelines of financial institutions rarely adopts a 'gender perspective' or 'gender mainstreaming approach'. Moreover, Marston concludes in its research that "as of the most recent research, there is little or no systematic guidance exists to help companies mainstream and report on gender-sensitive practices globally".[85] However, a large number of international standards exist – as shown in section 2.4.2 – which could help companies – including financial institutions – to promote gender equality. Nevertheless, these standards haven't been formulated yet in a practical tool for business.

However, the private sector itself is becoming an increasing driver for change, particularly with growing evidence that women's leadership and entrepreneurship makes important contributions to economic gains and business effectiveness.[86] The policies of financial institutions, both as a direct employer and as an influencer in other parts of the value chain, can have a great impact on achieving gender equality.

### 2.4.2 International Standards

Equality between women and men has been widely recognized in specific human rights and international sustainability standards. The most relevant are the following:

- **United Nations Charter, the Universal Declaration of Human Rights and the International Bill of Rights**

  Gender equality is at the very heart of human rights and United Nations values.[87] The United Nations Charter adopted in 1945 establishes as a fundamental principle the "equal rights of men and women".[88]

  Moreover, the 1948 United Nations' Universal Declaration of Human Rights formulates the right to equality and non-discrimination: "Everyone is entitled to all the rights and freedoms set forth in this Declaration, without distinction of any kind, such as race, colour, sex, language, religion, political or other opinion, national or social origin, property, birth or other status".[89] The right to equality and non-discrimination is also recognized in the United Nations' International Covenant on Civil and Political Rights and the International Covenant on Economic, Social and Cultural Rights.

  *This leads to assessment elements 1, 6 and 8.*

- **Convention on the Elimination of all forms of Discrimination against Women**

  The Convention on the Elimination of all forms of Discrimination against Women (CEDAW) is the main international treaty for women's rights. Adopted by the United Nations in 1979, it defines what constitutes discrimination against women and sets up an agenda for national action to end such discrimination.[90]

  CEDAW provides the legal basis for developing international legal regulation on women, business and human rights when imposing the obligations to prevent violations by private individuals and actors:

  - According to the Committee on the Elimination of all forms of Discrimination against Women (CCEDAW) state parties must "protect women from discrimination by private actors".[91] In that sense, state parties must "react actively against discrimination against women, regardless of whether such acts or omissions are perpetrated by the State or by private actors."[92]
  - In addition, state parties must "formulate and implement a policy that is targeted as clearly as possible towards the goal of fully eliminating all forms of discrimination against women and achieving women's substantive equality with men."[93] The policy "must be comprehensive" and "apply to both public and private economic spheres".[94] Finally, this "policy must engage the private sector, including business enterprises, the media, organizations, community groups and individuals, and enlist their involvement in adopting measures that will fulfil the goals of the Convention in the private economic sphere".[95]
  - Moreover, "the full implementation of the Convention required States to take positive measures to eliminate all forms of violence against women".[96]

Although the state party is ultimately responsible for carrying out the obligations under CEDAW, non-state actors, including business entities, play a critical role in ensuring that women enjoy their rights to non-discrimination and substantive equality. For example, in the concluding observations, CEDAW has made recommendations directly to the media and health care providers.[97]

*This leads to assessment elements 1, 6, 7, and 8.*

- **International Labour Organization**

Gender equality is a main element for the International Labour Organization (ILO) in reaching its primary goal of promoting opportunities for women and men to obtain decent work.[98] This is reflected in relevant international labour standards, but also in the increasing research focus of the ILO on gender equality.[99] The four key ILO gender equality Conventions are the following:

- The Equal Remuneration Convention (No. 100);
- Discrimination (Employment and Occupation) Convention (No. 111);
- Workers with Family Responsibilities Convention (No. 156); and
- Maternity Protection Convention (No. 183).

Conventions 100 and 111 are also among the ILO Declaration on Fundamental Principles and Rights at Work, making clear that equality and non-discrimination are also at the very heart of the ILO.

In addition, the ILO has also specifically addressed multinationals and the private sector in its Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy. The Tripartite Declaration contains two relevant references to gender equality that are aligned with ILO Conventions 100 and 111. These are the following:

- Multinational enterprises should be guided by the principle of "equality of opportunity and treatment" throughout their operations.[100]
- Multinational enterprises should base hiring procedures on qualifications, skills and experience, and offer staff training on all levels and to avoid discrimination of employees (based on ethnicity, gender or social background).[101]

*This leads to assessment elements 1, 2, 3, 8 and 9.*

- **United Nations Guiding Principles on Business and Human Rights**

The United Nations Guiding Principles on Business and Human Rights (UNGPs) make brief, but valuable mention to the principle of non-discrimination and the unique risks women and men face in the context of business activities:

- The preamble reads: "These Guiding Principles should be implemented in a non-discriminatory manner, (…) and with due regard to the different risks that may be faced by women and men".[102]
- In addition, when conducting human rights due diligence "business enterprises should pay special attention to any particular human rights impacts on individuals from groups or populations that may be at heightened risk of vulnerability or marginalization, and bear in mind the different risks that may be faced by women and men".[103]

The Gender, Business and Human Rights Reference Group has elaborated how to integrate a gender perspective into the business responsibility to respect human rights.[104] Its main recommendations are the following:

- Include gender mainstreaming within policies and procedures;
- Collect and analyse sex-disaggregated data for assessing and addressing human rights impacts; [105]

Importantly, the UN Working Group on the issue of human rights and transnational corporations and other business enterprises, as well as the Office of the High Commissioner on Human Rights, are advancing gender within the business and human rights agenda. This provides the opportunity to further elaborate the meaning of the UNGPs for women's rights issues in the context of business and how they can be applied.

*This leads to assessment element 7.*

- **Beijing Declaration and Platform for Action**

The Beijing Declaration and Platform for Action Beijing Declaration was produced after the 1995 United Nations' Fourth World Conference on Women. The Beijing Declaration contains a standard for gender balance in decision-making positions. According to the Beijing Declaration, women's full participation on the basis of equality in all spheres of society, including participation in the decision-making process and access to power, are fundamental for the achievement of gender equality.[106] With that regard, the Beijing Declaration calls on governments and the private sector for:

"Strategic objective G.1: Take measures to ensure women's equal access to and full participation in power structures and decision-making".[107]

This objective has been operationalized by, among other indicators, requiring gender quotas for senior level positions and corporate boards. In that sense, it is relevant to mention that the European Commission has formulated a proposal of a Directive which sets a minimum objective of 40% of the under-represented sex in non-executive board-members position in publicly listed companies in Europe by 2020, or 2018 for public undertakings.[108] Moreover, a number of EU member states, including Belgium, France, the Netherlands, and Sweden have adopted (before the European Commission's Directive proposal) different types of laws, including binding and voluntary gender quotas, for company boards.[109]

*This leads to assessment elements 4, 5, 11 and 12.*

- **OECD Guidelines**

The OECD Guidelines for Multinational Enterprises also contain relevant standards for responsible enterprise behaviour on gender equality:

- Enterprises are expected to "promote equal opportunities for women and men with special emphasis on equal criteria for selection, remuneration, and promotion, and equal application of those criteria, and prevent discrimination or dismissals on the grounds of marriage, pregnancy or parenthood".[110]
- Moreover, business enterprises should pay special attention to any particular human rights impacts on individuals from groups or populations that may be at heightened risk in particular industry and context, as for example women.[111]
- In addition, the OECD Guidelines recognizes that companies are often part of long production chains. They can monitor one another and question how they respect local

and national legislation and international norms on gender equality. The requirements that companies set for their suppliers can be included in contractual agreements.[112]

*This leads to assessment elements 1, 2, 3, 7, 8, 9 and 10.*

- **IFC Performance Standards**

  The relevant IFC Performance Standards on gender equality are the following:

  - “The client will base the employment relationship on the principle of equal opportunity and fair treatment, and will not discriminate with respect to any aspects of the employment relationship, such as recruitment and hiring, compensation (including wages and benefits), working conditions and terms of employment, access to training, job assignment, promotion, termination of employment or retirement, and disciplinary practices”.[113]
  - "The client will take measures to prevent and address harassment, intimidation, and/or exploitation, especially in regard to women".[114]

  *This leads to assessment elements 1, 2and 8.*

- **Women’s empowerment principles**

  The Women’s Empowerment Principles are a joint undertaking of the Global Compact and UN Women. These principles provide a tool for business to assess and benchmark their own business policies and practices against gender equality international standards. The principles are the following:

  1. Establish high-level corporate leadership for gender equality. Relevant organizational goals are:

     - Ensure that all policies are gender-sensitive.

  2. Treat all women and men fairly at work - respect and support human rights and non-discrimination. Relevant organizational goals are:

     - Pay equal remuneration, including benefits, for work of equal value and strive to pay a living wage to all women and men.
     - Ensure that workplace policies and practices are free from gender-based discrimination.
     - Implement gender-sensitive recruitment and retention practices and proactively recruit and appoint women to managerial and executive positions and to the corporate board of directors.

  3. Ensure the health, safety and well-being of all women and men workers. Relevant organizational goals are:

     - Establish a zero-tolerance policy towards all forms of violence at work, including verbal and/or physical abuse and prevent sexual harassment.

  4. Promote education, training and professional development for women.

5. Implement enterprise development, supply chain and marketing practices that empower women. Relevant organizational goals are:

    - Support gender-sensitive solutions to credit and lending barriers.
    - Ask business partners and peers to respect the company's commitment to advancing equality and inclusion.
    - Ensure that company products, services and facilities are not used for human trafficking and/or labour or sexual exploitation.

6. Promote equality through community initiatives and advocacy.

7. Measure and publicly report on progress to achieve gender equality. Relevant organizational goals are:

    - Make public the company policies and implementation plan for promoting gender equality.
    - Establish benchmarks that quantify inclusion of women at all levels.
    - Measure and report on progress, both internally and externally, using data disaggregated by sex.
    - Incorporate gender markers into ongoing reporting obligations.

*This leads to assessment elements 1, 2, 3, 8, 9 and 10.*

- **The UN Declaration on the Rights of Indigenous Peoples**

  The UN Declaration on the Rights of Indigenous Peoples adopted by the UN General Assembly in 1997 calls on States to pay particular attention to the rights and special needs of indigenous women when measures are taken to ensure continuing improvement of economic and social conditions. It also calls for full protection and guarantees against all forms of violence and discrimination against women.[115]

  *This leads to assessment element 1 and 6.*

### 2.4.3 Assessment elements

The following elements are crucial for a policy regarding the financial institution's internal operations:

1. The financial institution has a zero tolerance policy commitment for all forms of gender discrimination with respect to employment and occupation, including verbal, physical and sexual harassment.
2. The financial institution has systems in place to actively manage pay equity: it identifies gendered pay differences within the organization – at difference functions – by gathering comprehensive pay data.
3. The financial institution has systems in place to prevent and mitigate gender discrimination of its customers: it identifies gendered differences by gathering comprehensive data.
4. The financial institution guarantees at least 40% participation and equal access of women at senior level positions.
5. The financial institution guarantees at least 40% participation and equal access of women in the Board of Directors.

The following elements are crucial for a policy regarding companies a financial institution invests in or finances:

6. Governments have formulated laws or policies to eliminate all forms of discrimination and violence against women and work towards women's substantive equality with men.
7. Companies have a policy commitment to differentiate the human rights risks faced by women and men.
8. Companies have a zero tolerance policy for all forms of gender discrimination including verbal, physical and sexual harassment.
9. Companies have systems in place to actively manage pay equity: companies identify gendered pay differences within the organization – at different function levels – by gathering comprehensive pay data.
10. Companies have systems in place to prevent and mitigate gender discrimination of its customers: companies collect and analyse sex-disaggregated data for assessing and addressing human rights impacts of its customers.
11. Companies guarantee at least 40% participation and equal access of women at senior level positions.
12. Companies guarantee at least 40% participation and equal access of women in the Board of Directors.
13. Companies include gender and women's rights criteria in their procurement and operational policies.
14. Companies include clauses on the compliance with gender and women's rights criteria in their contracts with subcontractors and suppliers.

## 2.5 Health

### 2.5.1 What is at stake?

Good health is of great value, for individuals as well as for the economy. Globally, health care costs are rapidly increasing and for a lot of developing countries these costs are hard to bear. Furthermore, illness or handicap decrease labour productivity and also limits the abilities of individuals to contribute to the society in which they live. For this reason it is of great social and economic importance that companies put health on the agenda.

The right to health is an acknowledged human right, which was first formulated in 1946 at the foundation of the World Health Organisation (WHO) as "the enjoyment of the highest attainable standard of health".[116] The right to health is also recognized in the International Covenant on Economic, Social and Cultural Rights (ICESCR) as "the right to enjoy the highest possible standard of physical and mental health".[117] The right to health is also mentioned in Article 25 of the Universal Declaration of Human Rights.

In 2002 the first United Nations Special Representative of the Secretary-General on the Right to Health, Paul Hunt, was appointed. As required by his mandate, Hunt further developed the content of the Right to Health. According to Hunt, the right to health is broader than access to health care and includes safe drinking water, proper sanitary provisions, safe food, housing, healthy working conditions, education and information on health, and gender equality. In addition, the health care provisions have to be accessible to everyone both physically as well as economically, without any distinction made. This interpretation has been accepted by both the Office of the High Commissioner of Human Rights and the Committee on Economic, Social and Cultural Rights.[118]

When it comes to responsibilities, the WHO points out that not only governments must take responsibility regarding the “right to health”, but that companies should do so as well. However, there is not yet (scientific and political) agreement as to the extent and the exact interpretation of this responsibility.[119] According to ISO 26000, companies should first prevent affecting the health of their employees, clients, and nearby residents with their products and production processes.[120] Furthermore, companies should ensure that their employees and employees of their suppliers are not exposed to hazardous substances, that they do not incur diseases during their work, and that they do not have to work in dangerous circumstances. According to the United Nations International Labour Organisation (ILO), every day 6,300 people die as a result of occupational accidents or work-related diseases – more than 2.3 million deaths per year. The number of non-fatal accidents at work, many of these resulting in extended absences from work, is estimated by the ILO at 317 million each year globally.[121]

According to the WHO unsafe or inadequate water, sanitation, and hygiene cause approximately over 2 million deaths annually. Almost 1 billion people lack access to safe drinking water.[122] Sectors such as agriculture, fishing, and animal husbandry all rely on the presence of sufficient and clean water. Women, children, and the economically disadvantaged are the most severely affected by water quality impacts. Over 90 percent of those who die as a result of water-related diseases are children under the age of 5.[123]

The WHO states that reduction of emissions of greenhouse gasses through better transport, food and energy-use choices can also result in improved health.[124] Emissions caused by transport are harmful to public health, the European Environment Agency stresses. Especially in cities, air quality levels are a fundamental issue for public health.[125] Air quality is also at risk from an increase of peat fires worldwide, leading to serious air pollution. Haze caused by peat fires can cause serious long-term health problems. The WHO estimates that each year around 110,000 deaths associated with particulate matter exposure in Southeast Asia can be attributed to peat fires.[126]

Globally, tens of thousands of chemical compounds are used that are released into the environment during or after the production or use phase. A lot of chemicals can spread far over land and oceans and by plants, animals, and people, including through the skin or the mouth. This is risky because of only 14% of the most used chemical compounds information is available on their consequences for the environment, human health, and pregnancies.[127] The use of these chemicals precedes scientific insight into the environmental and health effects of the substances in question. Moreover, legislation is always lagging behind the latest scientific insights. This cannot be used as an excuse to delay measures that prevent harm to the environment and to people’s health.[128]

Even if everybody complies with the existing rules, it could occur that new, harmful toxic substances spread globally and pose a threat to the environment and to human health - as happened previously with PCBs. Therefore, all parties involved have to do more than comply with the existing rules: as a precaution, the use of any toxic substance of which the consequences are unknown should be terminated. This precautionary principle can be applied widely but certainly have to be applied to two groups of chemicals:[129]

- *Endocrine Disrupting Chemicals (EDCs)*: these are chemicals such as BPA, phthalates and BFRs, that block, imitate, or otherwise disturb naturally produced hormones. Hormones are the chemical messengers of the body that control how organisms develop and function.
- *Persistent Organic Pollutants (POPs)*: these are chemicals that degrade slowly in nature or do not degrade at all. Once entered into a human being or animal they accumulate in the body.

As well as preventing harm to nature and health damage to employees, consumers and nearby residents, companies could also consider how to support access to essential health provisions, clean drinking water and adequate sanitation. Furthermore, it is important to pay attention to improving health. Appropriate recommendations include stimulating a healthy lifestyle, discouraging the consumption of unhealthy products and substances and contributing to accessible medication and vaccinations. Special attention should be paid to food for children.[130]

One in every four of the world's inhabitants has insufficient access to essential, reliable and affordable health care.[131] According to the WHO, with better access to medication, ten million people that die of avoidable or treatable diseases such as HIV/Aids, malaria and tuberculosis could be saved annually.[132] The fight against HIV/Aids, malaria and other diseases is one of the eight Sustainable Development Goals (SDGs). Pharmaceutical companies could play an important role, but presently some hardly invest money in developing vaccines or medication for a lot of common tropical diseases, because the people suffering from these diseases do not represent a group with purchasing power. Also, these companies sometimes stick to their patents as long as possible, which makes it impossible to bring existing medication to the market at an affordable price.[133]

Financial institutions should take all these aspects into account when developing policies on health. To do this, financial institutions can make use of the international standards described below.

### 2.5.2 International standards

The main international standards on health are summarised below.

- **An adequate standard of living**

  According to Article 25 of the Universal Declaration of Human Rights, "everyone has the right to a standard of living adequate for the health and well-being of himself and of his family, including food, clothing, housing and medical care and necessary social services, and the right to security in the event of unemployment, sickness, disability, widowhood, old age or other lack of livelihood in circumstances beyond his control".

  These rights have also been protected by The International Covenant on Economic, Social and Cultural Rights (ICESCR) . Article 12 of this Covenant guarantees the right to an adequate standard of living including adequate food, clothing, housing and continuous improvement of living conditions. This Article has also been interpreted as including access to sufficient water and sanitation.

  An important indication of the standard of living for countries is life expectancy. To compare countries, the United Nations developed the Human Development Index (HDI), a combination of per capita income, life expectancy and illiteracy percentage.

  Another important indication of the standard of living for countries is if and how the human right to water and sanitation is respected. The Institute for Human Rights and Business has published a report to help business integrate human rights consideration in relation to water into business policies and practices.[134] In 2015 the UN Global Compact launched the CEO Water Mandate initiative on water and sanitation, which is intended to help companies translate their responsibility to respect these rights into their existing water management policies and practices.

  *This leads to assessment element 1.*

- **Health and safety at work**

  Employers are responsible for the health and safety of their employees and this is included in various international standards:

  - The Occupational Health and safety Convention adopted in June 1981 by the United Nations International Labour organisation (the ILO) is the main international standard on health and safety at work. The treaty clarifies what responsibilities companies have in this respect and what rights employees have. During the course of time, this convention has been completed and solidified with ILO-conventions that concern specific dangers for the health and safety of employees, such as the Asbestos Convention and the Chemicals Convention, as well as on specific industries such as the Safety and health in Agriculture Convention, the Safety and health in Mines Convention and the Health and safety in Construction Convention. Moreover, the ILO publishes the so-called *Codes or Practice* for 35 various industries and issues with concrete measures to improve health and safety.[135]
  - However, maintaining minimum standards on health and safety proves not to be sufficient, according to the ILO a continuous and systematic pursuit to improve the health and safety of employees is necessary. With that objective in mind, in 2006 the Promotional Framework for Occupational Health and safety Convention was adopted. In this convention, countries and companies are encouraged to do more to systematically improve the health and safety of employees and develop a preventive culture in the field of health and safety.[136]
  - The United Nations Food and Agriculture Organisation (FAO) publishes the International Code of Conduct on the Distribution and Use of Pesticides, which sets the standard on the application, processing, and disposal of pesticides.
  - The international standard OHSAS 18001 provides guidelines, for a management system, regarding Occupational Health and Safety. This can be applied to all kinds of organisations. Its purpose is guaranteeing the health and safety of both employees and external stakeholders, such as contractors staff and visitors.

  *This leads to assessment elements 1, 2 and 3.*

- **Ban on production and use of certain toxic substances**

  There are various international agreements that prohibit or phase out the production and use of various hazardous or toxic substances. The main examples are:

  - The Montreal Protocol on Ozone Depleting Substances was drafted in September 1987 and has been repeatedly tightened since. The protocol prohibits the production and the use of products that affect the ozone layer, such as chlorofluorocarbons (CFKs and HCFKs), halons and methyl bromide.
  - The Stockholm Convention on Persistent Organic Pollutants was drafted in May 2001. This convention focuses on banning *Persistent Organic Pollutants* (POPs - persistent organic pollutants). POPs are chemicals that remain in the environment for a long period of time and which spread over large areas, accumulate in the fat of living organisms and are highly toxic for human beings and animals. POPs that have been prohibited globally, include DDT, dieldrin, dioxins and PCBs. A lot of these substances have been used in pesticides. The list is updated regularly and the latest change dates back from 2013.[137]

  *This leads to assessment elements 4 and 5.*

- **Control of the environment and health consequences of chemicals**

  The international community increasingly acknowledges the need to estimate the possible long-term consequences of chemicals to human health and the environment in advance. Various agreements focus on a better analysis of the possible consequences and on a more cautious approach to introducing, producing, and using chemicals of which the effects are uncertain.

  - In 1980, the International Programme on Chemical Safety (IPCS) was established by the three United Nations organisations WHO, ILO, and UNEP. The IPCS disseminates scientific knowledge on the environment and health consequences of chemicals and helps governments to enhance their capacity in this field. The IPCS publishes an authoritative classification of pesticides based on the health risks they pose, the WHO Recommended Classification of Pesticides by Hazard.
  - During the World Summit for Sustainable Development in Johannesburg in August 2002, it was decided that the Globally Harmonized System of Classification and Labelling of Chemicals (GHS) be introduced, which was revised in 2007. With the GHS system that is now implemented and led by the United Nations Economic Commission for Europe, chemical substances all over the world are classified in the same way. In this way, rapid exchange of information on environmental and health effects is improved.
  - In February 2006, the Strategic Approach to International Chemicals Management (SAICM) was adopted by theInternational Conference on Chemicals Management (ICCM). SAICM, which operates under the flag of the *United Nations Environment Programme* (UNEP), provides governments with a policy framework that can result in chemicals, including chemical waste and by-products, being dealt with in a safe and sustainable way.
  - The precautionary principle entails that companies need to be responsible and proactive in avoiding certain risks. In relation to chemicals, when the risks involved with the use of a substance cannot be satisfactorily quantified and removed, even if a cause and effect relationship has not been fully proven scientifically, then this substance should not be used. The burden of proof for the safety of a chemical should lie with the company and not with the public. This is also the case when a substance is not restricted or regulated by the government. Furthermore, the principle also entails considering alternatives and considering the full impacts of a substance over time.[138]
  - In June 2007, the European regulation for the Registration, Evaluation, Authorisation and Restriction of Chemicals (REACH) came into force. This regulation is adopted in order to better protect people's health and the environment from the risks that chemical substances can bring about. At the same time it should enhance the competitive position of the chemical industry in the EU. It should also ensure a decrease of animal testing in the sector. The implementation of REACH is in the hands of the European Chemicals Agency (ECHA).[139] In order to live up to the regulation companies must identify and control the risks they run concerning the substances they produce or introduce on the market within the EU. They must show how the substance can be used safely and they must announce to their users how the risks are restricted. If the risks cannot be prevented the authorities may limit the use of these substances. This is in line with the precautionary principle. In the long term the most dangerous substances must be replaced. Under REACH all companies in a supply chain of chemical substances (producers, importers, users, buyers) are responsible. REACH relies on the precautionary principle and is an example of how this can be operationalised.[140]
  - The European Union has various guidelines for emissions of harmful substances to water and air. These dictate the use of the Best Available Technology (BAT). European companies are also expected to comply with the European standards outside the EU and other companies may be expected to follow the example of these European standards.

- The OECD Guidelines for Multinational Enterprises recommend companies to educate and train their employees in issues concerning the environment and health and safety, including the handling of toxic substances. In addition, companies should ensure that their products and services meet all health and safety standards for consumers. Companies also have to inform consumers on this.

*This leads to assessment elements 8 and 9.*

- **International trade in chemicals and chemical waste**

Dumping chemical waste and chemicals prohibited in their own country and in less developed countries is constrained by two international conventions:

- In the 1989 Basel Convention on the Control or Transboundary Movements of Hazardous Wastes and their Disposal, clear agreements have been made on the international trade in, and safe processing of, hazardous (chemical) waste. The 178 signatory countries oblige themselves to restrict the international trade in hazardous waste as much as possible, to process hazardous waste as close as possible to the place where it is created and to limit hazardous waste as much as possible.
- The Rotterdam Convention on the Prior Informed Consent Procedure for Certain Hazardous Chemicals and Pesticides in International Trade was established in 1998. The convention determines that pesticides and other hazardous chemicals be prohibited in their own country and may not be exported to other (developing) countries.

This leads to assessment elements 6 and 7.

- **Access to medicine**

The standard on access to medicine is set by the Access to Medicine Index. The last edition of the index was published in November 2014 and showed that the 20 largest pharmaceutical companies significantly vary in their efforts to give patients in developing countries more access to affordable medication and vaccines. Some large manufacturers make good progress, for example having strong research pipelines pricing strategies that target the poor, and manage intellectual property in ways that stimulate competition.[141]. Other companies remain behind in the implementation of such innovations. The 2014 index uses 95 indicators, grouped into seven subjects, to assess and compare the policy of large pharmaceutical companies with regard to access to medication.[142]

The Access to Medicine Index is supported by 32 leading global investment institutions that combined manage over USD 5.35 trillion. The investors call it a tool which “may be useful to assess the long-term value of pharmaceutical companies.”[143]

*This leads to assessment element 10 and 11.*

- **Bottle feeding**

  According to figures of the World Health Organisation (WHO) 1.5 million children die annually and even more get sick because they are not breastfed. Breastfeeding is demonstrably better for the health of infants than bottle-feeding. However, the number of women who are breastfeeding is declining worldwide. An important cause is the advertisement of bottle feeding that makes many parents unnecessarily switch to bottle feeding. Therefore, since 1981 the World Health Organisation International Code of Marketing of Breast-milk Substitutes has prohibited advertising breast-milk substitutes. Virtually all countries in the world have signed the WHO-code, but not all countries have included the WHO-code and the later signed resolutions in their own legislation. The International Baby Food Action Network (IBFAN) is therefore committed to realise that manufacturers always and everywhere comply with the WHO-code and the additional resolutions. The Access to Nutrition Index provides a ranking of companies that produce breast-milk substitutes (BMS), in which the compliance of manufacturers of BMS manufacturers with the WHO Code and subsequent WHA resolutions is assessed.[144]

  *This leads to assessment element 12.*

- **Passive smoking**

  The Framework Convention on Tobacco Control of the World Health Organisation (WHO) is ratified by 168 states. Governments, but also companies, can make use of the measures and recommendations to reduce the demand and supply of tobacco and passive smoking. A number of governments however, has not yet developed relevant legislation regarding this topic.

  *This leads to assessment element 13.*

- **Procurement and supply chains**

  Companies are often part of long production chains. They can monitor one another and question how they respect local and national legislation and international norms on labour rights. The requirements that companies set for their suppliers can be included in contractual agreements. The importance of this has also been recognised in the OECD Guidelines for Multinational Enterprises since its revision in 2011.

  Furthermore, the ISO 26000 guideline recognises the importance of supply chain responsibility, because “the impacts of an organization's decisions or activities can be greatly affected by its relationships with other organizations.” ISO 26000 recognizes that a companies’ sphere of influence includes relationships within and beyond an organization’s supply chain.[145]

  This leads to assesme*nt elements 14 and 15.*

### 2.5.3 Assessment elements

A solid policy on health should ensure that financial institutions only finance or invest in companies that take their responsibility towards health seriously and act based on the precautionary principle.

The following elements are crucial for a policy regarding the companies a financial institution invests in or finances:

1. Companies prevent the deterioration of the health of employees, clients and nearby residents by products or production processes (according to the precautionary principle).
2. Companies respect labour rights concerning health and safety at work, as described in the ILO conventions and the Tripartite Declaration.
3. Companies work on systematically improving the health and safety of employees and develop a preventive culture in the field of health and safety.
4. Companies respect international agreements on the production and the use of hazardous or toxic substances as described in the Montreal Protocol (on substances that deplete the ozone layer)
5. Companies respect international agreements on the production and the use of hazardous or toxic substances as described in the Stockholm Convention (on POPs).
6. Companies respect international agreements on trade in chemicals and chemical waste as stated in the Basel convention.
7. Companies respect international agreements on trade in chemicals and chemical waste as stated in the Rotterdam convention.
8. Companies reduce the emission of harmful substances (to soil, water, and air) by making use of the best available technologies (BAT).
9. Companies restrict the use of chemicals suspected to be harmful to health in scientific literature and, if necessary, only in a responsible way (precautionary principle).
10. Pharmaceutical companies ensure that patients with avoidable and treatable diseases have the right to access to medication.
11. Patients with avoidable and treatable diseases have the right to access to medication.
12. Manufacturers of bottle-feeding comply with the WHO-code and additional resolutions on advertisement for breast-milk substitutes.
13. Tobacco manufacturers comply with the WHO Framework Convention on Tobacco Control and additional resolutions on the protection of current and future generations against the health, social, environmental and economic consequences of (passive) smoking.
14. Companies integrate health criteria in their procurement and operational policies.
15. Companies include clauses on the compliance with criteria on health in their contracts with subcontractors and suppliers.

## 2.6 Human rights

### 2.6.1 What is at stake?

Human rights are rights and freedoms inherent to all human beings, whatever their nationality, place of residence, sex, national or ethnic origin, colour, religion, language, or any other status.[146] The rights and freedoms that are generally considered as human rights comprise of civil and political rights – such as the right to life, freedom of expression and equality before the law – and economic, social and cultural rights – such as the right to an adequate standard of living, the right to food, work and education. Human rights also include collective rights, such as the rights to development and self-determination.

On 10 December 1948, the United Nations General Assembly adopted the Universal Declaration of Human Rights (UDHR) that for the first time in human history spelled out 30 basic civil, political, economic, social and cultural rights that all human beings should enjoy. It has over time been widely accepted as the fundamental principles of human rights that everyone should adhere to. Through a series of international human rights treaties and other instruments these inherent human rights have developed into a body of legal international human rights. While international treaties and customary law form the backbone of international human rights law, other instruments, such as declarations, guidelines and principles adopted at the international level contribute to its understanding, implementation and development.

There are particular groups who, for various reasons, are vulnerable or have traditionally been victims of violations and consequently require special protection for the equal and effective enjoyment of their human rights, such as women and girls, children, disabled persons, migrant workers and indigenous peoples. Specific human rights instruments, such as the Convention on the Rights of the Child or the Convention on the Elimination of All Forms of Discrimination against Women, have been developed set out additional guarantees for persons belonging to these groups.[147]

Globalisation presents new and complex challenges for the protection of human rights. Economic players, especially multinational companies that operate across national borders, have gained unprecedented power and influence across the world. Companies have an enormous impact on people's lives and the communities in which they operate. Sometimes the impact is positive - jobs are created, new technology improves lives and investment in the community translates into real benefits for those who live there. But there are also countless instances when corporations impact negatively, such as when exploiting weak and poorly enforced domestic regulation.

In some industrial sectors, such as the extractive sector, the risks for human rights abuses are particularly high. Traditional livelihoods can be destroyed as land is contaminated and water supplies polluted. In this scenario, economic, social and cultural rights at stake are for example the right to food, work, housing, health and a healthy environment. Moreover, the impact can be particularly severe for certain specific groups, such as indigenous peoples because their way of life and their identity is often closely related to their land. Moreover, far too often, companies operating across borders are involved in severe abuses, such as child labour, forced labour or forced evictions. In addition, affected communities are frequently denied access to information about the impact of company operations. This means that they are excluded from participating in decisions that affect their lives. And, often when communities attempt to get justice, they are thwarted by ineffective legal systems, corruption or powerful state-corporate alliances. Worryingly, when the poor cannot secure justice, companies learn that they can exploit poverty without consequences.[148]

Under international human rights law, states have an obligation to protect human rights, which requires taking measures by states to ensure that other actors, including companies, do not undermine or violate human rights. Importantly, the fact of government failure to protect human rights does not absolve the non-state actor from responsibility for their adverse human rights impacts. As also described in section 2.6.2 it is now widely accepted that companies have a responsibility to respect human rights.

The corporate responsibility to respect human rights was formulated in 2008 within the *Prospect, Respect and Remedy Framework* that the former UN Special Representative of the Secretary-General on the issue of human rights and transnational companies and other business enterprises, Prof. John Ruggie formulated. This Framework rests on three pillars:[149]

- the state duty to protect against human rights abuses by third parties, including business enterprises;
- the corporate responsibility to respect human rights; and
- the need for greater access by victims to effective remedy, both judicial and non-judicial.

At the request of the UN Human Rights Council (HRC), Ruggie operationalised his Framework, resulting in the United Nations Guiding Principles on Business and Human Rights (UNGPs) which were unanimously endorsed by the HRC in June 2011.[150] The UNGPs are currently considered the main global standard addressing the risks of adverse impacts on human rights that are linked to business activities. It is well established that this corporate responsibility also applies to the entire range of financial institutions and actors, including commercial banks, retail banks, investment banks, rating agencies, financial service providers, and institutional investors.[151]

### 2.6.2 International standards

When developing strong human rights policies and practice, the following international human rights standards and norms should be utilized as a benchmark.

- **International Bill of Human Rights**

  Because companies can have an impact on virtually the entire spectrum of internationally recognized human rights, their responsibility to respect applies to all such rights. In practice, some human rights may be at greater risk than others in particular industries or contexts, and therefore these should be the focus of heightened attention. However, situations may change, so all human rights should be the subject of periodic review.

  An authoritative list of the core internationally recognized human rights is contained in the International Bill of Human Rights, consisting of the Universal Declaration of Human Rights 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), coupled with the principles concerning fundamental rights in the eight ILO core conventions as set out in the Declaration on Fundamental Principles and Rights at Work (for the latter, see section 2.7).

  On 10 December 1948, the UN General Assembly adopted the Universal Declaration of Human Rights (UDHR), including civil, political, economic, social and cultural rights and freedoms in a single international human rights instrument. Examples include the right to life, to freedom of movement, to peaceful assembly, to thought, conscience and religion. According to the UDHR, everyone is entitled to all these rights and freedoms without distinction of any kind, such as race, colour, sex, language, religion, political or other opinion, national or social origin, property, birth, or other status.

  The International Covenant on Civil and Political Rights (ICCPR) was adopted in 1966 and comprises 55 articles that focus on civil and political rights and freedoms, such as the freedom of religion and expression, the freedom from torture, right to privacy, the right to a fair trial, or the rights participate in political and public life.

The International Covenant on Economic, Social and Cultural Rights (ICESCR) was adopted in 1966 and comprises of 31 articles related to the workplace, social security, family life, participation in cultural life, or access to housing, food, water, health care and education. The content of the rights protected by the ESCR has been elaborated by the Committee on Economic, Social and Cultural Rights. According to this committee, State Parties to the Covenant have to make sure that water and food are available, accessible and of good quality.[152] The right to health refers to the right to a healthy living environment as well as the right to physical and mental health.[153]

*This leads to assessment elements 1, 2, 6, 7, 9, 10 and 11.*

- **United Nations Guiding Principles on Business and Human Rights**

The United Nations Guiding Principles on Business and Human Rights (UNGPs) establishes that companies, including financial institutions, should respect human rights. The responsibility to respect human rights is a global standard of expected conduct for all companies wherever they operate. It exists independently of States' abilities and/or willingness to fulfil their own human rights obligations, and does not diminish those obligations. And it exists over and above compliance with national laws and regulations protecting human rights.

The responsibility to respect human rights requires that companies:[154]

- Avoid causing or contributing to adverse human rights impacts through their own activities, and address such impacts when they occur; and
- 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.

According to Principle 15 of the UNGPs, In order to meet their responsibility to respect human rights, companies should have in place:

- A *policy commitment* to meet their responsibility to respect human rights;
- A *human rights due-diligence process* to identify, prevent, mitigate and account for how they address their impacts on human rights; and
- Processes to enable the *remediation* of any adverse human rights impacts.

UNGPs 16 to 24 provide operational guidance on how the required policies and processes should be put into practice.

Regarding the responsibility to conduct due-diligence to seek to prevent or mitigate an adverse impact, it is recognized that financial institutions may have hundreds to thousands of clients, and that it may not always be practical to conduct extensive due-diligence on each of them. The UNGPs and OECD Guidelines instead expect companies, including financial institutions, to identify general areas where the risk of adverse impacts is most significant and to prioritize due-diligence on their clients accordingly, through screening and monitoring clients when the risk is high, and/or when a risk is brought to the attention of the company (e.g. by an external stakeholder).

If a company identifies a risk that will *cause* an adverse impact, it is within its powers to cease or prevent that impact and should make sure to do so. If a company identifies a risk of *contributing* to an adverse impact, it has control over its contribution and should therefore cease or prevent its contribution and use its leverage with other entities also contributing to the adverse impact to persuade them to cease or prevent any further impacts and to mitigate any remaining impacts to the greatest extent possible. In both cases, the enterprise should provide or *contribute to a remedy*.

If a company identifies a risk or is made aware of adverse impacts being *directly linked* to its operations, products, and services through its business relationships, it should seek to use its leverage to influence the entity causing the adverse impact to prevent or mitigate that impact and future impacts. This can be done by the company itself or in co-operation with other entities, as appropriate.

*This leads to assessment elements 1, 2, 3, 4, 5, 6 and 12.*

- **Land rights and forced evictions**

Human rights, particularly economic, social and cultural (ESC) rights, play a central role in land-related issues. However, there is no explicit recognition of a 'human right to land' within international human rights instruments. Those who face threats to their land rely on other rights, such as the right to food, the right to water, the right to housing and the right to work. These rights are included in the above mentioned International Covenant on Economic, Social and Cultural Rights (ICESCR).[155]

The right to adequate housing encompasses the right to live in security, peace and dignity. To realize this right, governments have an obligation to guarantee security of tenure, which essentially means a set of arrangements in the context of housing and land that will protect the occupants from forced evictions and other threats and harassment.[156]

As noted by the UN Special Rapporteur on Adequate Housing Raquel Rolnik: "Involuntary resettlement amounts to a forced eviction when it occurs without the provision of, and access to, appropriate forms of legal or other protection."[157] The effects of forced evictions can be very serious, especially for people who are already living in poverty. The former UN Commission on Human Rights (current Human Rights Council) has described forced evictions as a "gross violation of human rights, particularly the right to adequate housing."[158]

The protection measures that should be applied to all evictions have been clearly articulated in the Basic Principles and Guidelines on Development-based Evictions (2007) developed by the former UN Special Rapporteur on Adequate Housing, Miloon Kothari. The principles reflect existing standards and jurisprudence on this issue and include detailed guidance on steps that should be taken prior to, during and following evictions in order to ensure compliance with relevant principles of international human rights law.

The former UN Special Rapporteur on the right to food, Olivier de Schutter, has developed a set of core principles and measures to address the human rights challenge of large-scale land acquisition and leases. These principles include the notion that any shifts in land use can only take place with the free, prior and informed consent of the local communities concerned. This is particularly important for indigenous communities, in view of the discrimination and marginalization they have been historically subjected to.[159]

Furthermore, in May 2011, the Tirana Declaration was adopted by over 150 representatives of civil society organisations, social movements, grassroots organizations, international agencies, and governments - including the members and strategic partners of the International Land Coalition (ILC) such as the World Bank, FAO, IIED and the IFAD. The Declaration defines land grabbing as:

*"acquisitions or concessions that are one or more of the following: (i) in violation of human rights, particularly the equal rights of women; (ii) not based on free, prior and informed consent of the affected land-users; (iii) not based on a thorough assessment, or are in disregard of social, economic and environmental impacts, including the way they are gendered; (iv) not based on transparent contracts that specify clear and binding commitments about activities, employment and benefits sharing, and; (v) not based on effective democratic planning, independent oversight and meaningful participation."*

*This leads to assessment elements* 7 *and* 8*.*

- **Indigenous peoples' rights**

  Indigenous peoples often face a number of land related challenges. Some of the most commons include forced evictions due to development projects, discrimination, failure to respect and support indigenous modes of production such as pastoralism and subsistence hunting/gathering, dismissal of their customary systems of governing land and other natural resources, or disregard of their sacred sites and the spiritual relationship with their lands. Moreover, indigenous peoples' traditional lands are often located in remote areas that have fragile ecosystems which makes them more vulnerable to natural disasters.[160]

  The UN Declaration on the Rights of Indigenous Peoples, adopted in 2007, sets out the individual and collective rights of indigenous peoples, including their right to self-determination and to maintain and strengthen their distinct political, legal, economic, social and cultural institutions. The Declaration also prohibits discrimination against indigenous peoples. Moreover, it recognizes the rights of indigenous peoples to their land, habitat and other resources that they traditionally own, cultivate or otherwise use. In addition, indigenous people are guaranteed in the Declaration the right not to be forcibly removed from their lands or territories, and that no relocation shall take place without their free, prior and informed consent (FPIC) and after agreement on just and fair compensation and, where possible, with the option of return.

  On the other hand, article 8(j), the Convention on Biological Diversity (CBD), adopted in 1992, considers the fair and equal use and the advantages of biological diversity, and requires that traditional knowledge of indigenous and local communities can only be used with their permission. According to the related Nagoya Protocol this also applies to access to and utilization of genetic resources. Furthermore, the Akwé: Kon Guidelines require the conduct of cultural, environmental and social impact assessments regarding developments proposed to take place or which are likely to impact on sacred sites and on lands and waters traditionally occupied or used by indigenous and local communities.

International Labour Organisation (ILO) has also developed relevant international standards for indigenous peoples. ILO Convention Nr.169 on the *Identification of indigenous and tribal peoples* protects countries and habitats of indigenous peoples. The convention describes measures to protect the rights of these peoples on the use of areas they had traditionally access to and that are important for their livelihood and traditional activities. It includes the right of indigenous peoples to Free, Prior and Informed Consent (FPIC) on decisions that can influence their habitats and natural resources.[xii]

At the regional level, it is relevant to highlight that the *Inter-American Development Bank* recognises in its Operational Policy on Indigenous Peoples that the life and the culture of peoples that live in voluntary isolation or have not yet been in contact with the outside world have to be protected against potential investments. The bank obliges itself not to invest in or finance any project that may have negative consequences for these peoples.[161]

*This leads to assessment elements* 7 *and* 8*.*

- **Women's rights**

The main international treaty for women's rights Convention on the Elimination of All Forms of Discrimination against Women (CEDAW) was adopted in 1979. The CEDAW describes the global consensus on the changes that should take place to realize women's rights.. The Convention defines discrimination against women as "...any distinction, exclusion or restriction made on the basis of sex which has the effect or purpose of impairing or nullifying the recognition, enjoyment or exercise by women, irrespective of their marital status, on a basis of equality of men and women, of human rights and fundamental freedoms in the political, economic, social, cultural, civil or any other field."

Equal participation of indigenous women during consultation procedures (based on the FPIC-principle) has to be guaranteed. The Beijing Declaration of Indigenous Women requires "equal political participation in the Indigenous and modern structures of socio-political structures and systems at all levels".

The UN Declaration on the Rights of Indigenous Peoples calls on States to pay particular attention to the rights and special needs of indigenous women when measures are taken to ensure continuing improvement of economic and social conditions. It also calls for full protection and guarantees against all forms of violence and discrimination against women.

See for more information the theme Gender equality in section 2.4.

*This leads to assessment element* 9*.*

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xii In its Working Paper on FPIC the United Nations Workgroup Indigenous Peoples of the Sub-Commission on the Promotion and Protection of Human Rights describes the right of indigenous peoples to Free, Prior Informed Consent (FPIC) on decisions that can influence their habitats and natural resources. The FPIC-principle requires the full and timely publication of information on the potential consequences of proposed investment plans. Communities have the right to respond to this in a negotiation process. This gives them more influence in decision-making processes, offers them the opportunity to negotiate any direct advantages and to speak out in favour of or against the plans.

- **Children's rights**

The Convention on the Rights of the Child, adopted in 1989, contains the fundamental rights of children that State Parties need to respect, protect and fulfil, including the rights to survival, to be able to fully develop, to be protected from harmful influences, abuse and exploitation and to fully participate in the family and in social and cultural life.

In 2012, UNICEF, UN Global Compact and Save the Children released the Children's Rights and Business Principles, which is the first comprehensive set of principles to guide companies on the full range of actions they can take in the workplace, marketplace and community to respect and support children's rights.

Moreover, the UN Declaration on the Rights of Indigenous Peoples calls on States to pay particular attention to the rights and special needs of indigenous children when measures are taken to ensure continuing improvement of economic and social conditions. It also calls for full protection and guarantees against all forms of violence and discrimination against children.[162]

*This leads to assessment element 10.*

- **Activities in occupied territories**

International humanitarian law (IHL) applies in situations of armed conflict. It seeks to limit the effects of armed conflict by protecting persons who are not participating in hostilities, for example civilians, and by restricting and regulating the means and methods of warfare by combatants. IHL is inspired by considerations of humanity and aims to mitigate human suffering. IHL also includes provisions for situations of occupation and sets out obligations for the party occupying an areas to ensure the rights of the population in that area.

IHL regulating occupation is described in the Fourth Geneva Convention from 1949, most of which has become customary international law. Among others, this convention prohibits transfer of the occupying country's population into the territory, forcible transfer and confiscation of private land and property of the protected population, and changing the laws of the occupied territory. It also sets out that some of these violations (e.g. forcible transfer) amount to war crimes.

Settlements in occupied territory are consequences of, maintain and constitute various violations of IHL and customary international law. Beyond that, settlements and the infrastructure that enables settlements also violate human rights of the protected population, triggering human rights responsibilities of enterprises.[163]

The UNGPs prescribes that enterprises should respect human rights and IHL. Therefore, companies that endorsed the UNGPs are expected to have knowledge of both human rights and IHL, to ensure that the conduct of the businesses they support is in line with it. Companies need to make sure they do not enable settlements, including their economic activities, in occupied territories.

*This leads to assessment element 11.*

- **Other guidelines for companies**

  The OECD Guidelines for Multinational Enterprises are recommendations by governments to multinational corporations. They contain voluntary guidelines and standards for responsible enterprise behaviour in line with relevant legislation. According to the guidelines, companies have to respect the human rights of people affected by their activities. In the update of 2011, the recommendations were entirely aligned with the Ruggie Framework and its UNGPs.

  *This leads to assessment elements* 1, *2, 3, 4,* 5 and *12.*

  The ISO 26000 guidelines recognise the importance of human rights. In this guideline for social responsibility of organisations, 'respect for human right is one of the seven principles. In the core issue, the main underlying topics – risk situations, due diligence, avoiding complicity, solving grievances, discrimination and vulnerable groups, civil and political rights, economic, social and cultural rights and fundamental principles and labour rights – are elaborated further into actions and expectations.[164]

  ISO 26000 also recognize the importance of integrating human rights criteria in procurement. The guidelines state that companies are often part of long production chains, and ask companies to monitor one another as well as question how they respect local and national legislation and international norms on labour rights. The requirements that companies set for their suppliers can be included in contractual agreements.

  *This leads to assessment elements* 1*,* 2*,* 3*, 12 and 13.*

  The UN Global Compact also contains relevant principles, which are the following:

  - Businesses should support and respect the protection of internationally proclaimed human rights.
  - Businesses should make sure that they are not complicit in human rights abuses.

  *This leads to assessment elements* 1*,* 3 *and* 5*.*

### 2.6.3 Assessment elements

Although financial institutions are usually not directly involved in violations of human rights, they can be held jointly responsible if the companies or governments in which they invest violate human rights. After all, the responsibility to respect human rights requires companies not only not to cause, or contribute to, a negative impact on human rights with their own activities, but also to try to prevent or mitigate a negative impact on human rights made by their business relationships; when such is directly linked to their own operations, products or services, even if they did not contribute to this impact directly.[165]

The following elements are crucial for a policy regarding the financial institution's internal operations:

1. The financial institution respects all human rights as described in the United Nations Guiding Principles on Business and Human Rights.

The following elements are crucial for a policy regarding the companies a financial institution invests in or finances:

2. Governments respect, protect and fulfil all human rights as described in international declarations and conventions.
3. Companies respect all human rights as described in the United Nations Guiding Principles on Business and Human Rights.
4. Companies have a *policy commitment* to meet their responsibility to respect human rights.
5. Companies have a *human rights due diligence process* to identify, prevent, mitigate and account for how they address their impact on human rights.
6. Companies have processes to enable the *remediation* of any adverse human rights impact to which they cause or to which they contribute.
7. Companies prevent conflicts over land rights and acquire natural resources only by engaging in meaningful consultation with local communities and obtaining free, prior and informed consent (FPIC) when it concerns indigenous peoples.
8. Companies prevent conflict over land rights and acquire natural resources only with free, prior and informed consent (FPIC) of the land users involved.
9. Companies have special attention for respecting the rights of women, especially to prevent discrimination and to improve equal treatment of men and women.
10. Companies have special attention to respect the rights of children.
11. Companies respect International Humanitarian Law and do not enable settlements, including their economic activities, in occupied territories.
12. Companies integrate human rights criteria into their procurement and operational policies.
13. Companies include clauses on compliance with human rights criteria in their contracts with subcontractors and suppliers.

## 2.7 Labour rights

### 2.7.1 What is at stake?

Protecting people in their working environment is a fundamental responsibility of companies and governments. According to the International Labour Organisation (ILO), employees have the right to:

- good working conditions: a safe and healthy workplace, no discrimination;
- good labour conditions: remuneration, working hours, provisions, etc.; and
- respect of their labour rights: no child- or forced labour, the freedom of association, the right to collective bargaining and other rights.

All companies have to be able to prove that their employees work in a safe environment, that they are not discriminated against or mistreated, that they can deal freely with colleagues, labour unions and representative organisations, and that they are remunerated in a fair way for their services. These basic rights apply to all employees, regardless of their race, gender or religion. Meeting these conditions helps when developing a strong work force that can contribute to the development of sustainable *human capital*. In addition, ensuring labour rights can contribute to the democratisation of societies, which leads to a more favourable investment climate for the corporate world.

Higher wages and more stringent maximum working hours, investments in professional training and respect for equality lead to better trained and more satisfied employees. In addition, safety requirements are essential to prevent accidents and to minimise the number of people that need health care. Protection of employment agreements can encourage employees to think innovatively and choose new paths. Furthermore, developing direct communication channels between employees and employers and setting up grievance and mediation procedures can contribute to productivity growth and to a greater stability of the labour market.[166]

Special attention for the position of women in the labour market is also important. If women earn an income, this contributes strongly to the health and productivity of families and even communities as well as to improved prospects for their children and future generations.[167] The UN Convention on the Elimination of All Forms of Discrimination Against Women endorses the right of women not to be discriminated against on education, labour relations, and economic and social activities Working environments where men and women are treated equally are of great importance in helping to reduce poverty and improve the standards of living. In addition, it is important that such factors are also considered for women during and around the period of pregnancy. Sustainable Development Goal number 5 is aimed at ending discrimination against women and girls and eliminating all forms of violence against women and girls.

The financial and economic crises of recent years have also had an impact on the job market: there is less security and more precarious work for employees. In 2015, the rate of global unemployment reached 197.1 million – over 27 million higher than before the crisis. However, even among wage and salaried workers job insecurity is a major problem, as less than half have a permanent contract. The ILO concludes that the world community is facing a challenge to strengthen labour market institutions and ensure the proper design of social protection systems. In particular, financial reform is required to ensure that financial institutions perform their role of channelling resources into the real economy and into investments for sustainable enterprise expansion and job creation.[168] This is also the aim of Sustainable Developmet Goal 8: “Promote sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all”.[169]

The policy of financial institutions has to take care that they only invest in or finance companies that respect labour rights and provide decent jobs, ensuring proper working conditions. When developing policies in this respect, financial institutions can make use of the international standards described below.

### 2.7.2 International standards

With regard to labour rights the following international standards and norms are relevant:

- **ILO fundamental principles**

  The body that internationally establishes labour standards is the United Nations International Labour organisation (ILO) in which governments, employers, and employees cooperate. Up to now, the ILO has adopted 189 agreements (conventions) and 201 recommendations that combined deal with a wide spectrum of labour issues.[xiii]

[xiii] For a complete overview see the ILOLEX database, online:www.ilo.org/ilolex/english, viewed in March 2012.

With the adoption of the ILO Declaration on Fundamental Principles and Rights at Work in 1998, the ILO identified eight of its conventions as "fundamental" or "core" conventions. These eight cover four topics that are considered as the fundamental principles and rights at work:

- The freedom of association and the effective recognition of the right to collective bargaining;[170]
- The elimination of all forms of forced and compulsory labour;[171]
- The effective abolition of child labour;[172] and
- The elimination of discrimination in respect of employment and occupation.[173]

*This leads to assessment elements 1, 2, 3 and 4.*

- **Working conditions**

Another leading ILO document is the Tripartite Declaration of Principles Concerning Multinational Enterprises and Social Policy, adopted in 1977. The Tripartite Declaration focuses on the responsibility of companies and specifically on their dealings with labour issues. Besides the reaffirmation of the rights on freedom of association and collective bargaining and the ban on discrimination and forced labour, the agreement requires companies to:

- Improve working conditions and development opportunities, preferably hiring people from the local population, and the use of local materials and local production and processing capacity;
- Improve equal chances and treatment, by basing hiring procedures on qualifications, skills and experience, and to offer staff training on all levels and to avoid discrimination of employees (based on ethnicity, gender or social background);
- To protect employees and to avoid arbitrary dismissal. Whenever changes with major employment effects occur, these are to be disclosed in advance to labour unions and government authorities;
- To offer relevant education on all levels, for employees and management;
- To offer the best possible wages and fringe benefits for employees, in any case not considerably less than other local employers. The labour remuneration has to be linked to the economic position of the company and should at least provide in the basic needs of employees and their families;
- To achieve and preserve the highest standards of health and safety and to report any hazards to government authorities and employee organisations;
- To establish a procedure for regular consultation between employees and employers; and
- To establish a procedure to handle complaints.

*This leads to assessment elements 4, 5, 6, 7, 9 and 10.*

- **Living wage**

The ILO describes a living wage as "the level of wages sufficient to meet the basic living needs of an average-sized family in a particular economy."[174] ILO documents referring to living wage include the ILO Constitution and its preamble, the 2006 ILO Tripartite Declaration on Principles concerning Multinational Enterprises and Social Policy and the 2008 ILO Declaration on Social Justice for a Fair Globalization.

The United Nations Universal Declaration of Human Rights (1948) states that “everyone who works has the right to just and favourable remuneration ensuring for himself and his family an existence worthy of human dignity”.[175] In addition, the 2011 OECD Guidelines for Multinational Enterprises recommend paying a wage that “should be at least adequate to satisfy the basic needs of the workers and their families”.[176] Standards on workers’ rights and conditions such as the Ethical Trading Initiative (ETI) also mention that it should provide some discretionary income.[177]

The common ground of the above definitions is that a ‘living wage’ is regarded as a family income, should be sufficient to meet basic needs, usually conceived of as the ability to obtain adequate food, clean water, shelter, clothes, education, healthcare, transport and energy, and provide some discretionary income.[178]

Workers in many producing countries are not paid enough to support themselves and their families. While some of these countries do have a legal minimum wage, it is often much lower than a living wage. There is not yet an established formula for calculating living wage levels in different countries.

*This leads to assessment element 5.*

- **Children’s rights**

  The United Nations Convention on the Rights of the Child supports the appeal for the effective abolition of child labour.

  *This leads to assessment element 3.*

- **Women’s rights**

  The UN Convention on the Elimination of All Forms of Discrimination Against Women endorses the right of women not to be discriminated against on education, labour relations and economic and social activities.

  See for more information on this topic the theme theme Gender equality (section 2.4) and the theme Human rights (section 2.6).

  *This leads to assessment element 4.*

- **Migrant workers**

  The United Nations Convention on the Protection of the Rights of All Migrant Workers and Their Families adopted in 1990 emphasises the connection between migration and human rights and aims to protect migrant workers and their families. The Convention does not bring any new rights for migrants into existence, but intends to guarantee equal treatment and working conditions for migrants and nationals.

  *This leads to assessment element 8.*

- **Health and safety**

  Occupational Health and Safety Assessment Series (OHSAS) 18001 was developed as an international standard which should help companies to manage health and safety risks at work. This standard provides guidelines for a risk management system. It applies to all kinds of organisations and it serves to guarantee the health and safety of both employees and external stakeholders, for example construction staff and visitors.

OHSAS 18001 means that risks are surveyed structurally and evaluated too. The standard has been developed by the OHSAS Project Group, which is a consortium of i.a. certification organisations, governments and representatives of the industries. Presently, the standard is administered by the British Standards Institution (BSI).

*This leads to assessment element 7.*

- **Other guidelines for companies**

  Various guidelines for companies endorse the four fundamental ILO principles and rights at work, as well as the Tripartite Declaration:

  - According to the United Nations Guiding Principles on Business and Human Rights (UNGPs), the responsibility of companies includes the fundamental principles of the ILO, together with the International Bill of Human Rights;
  - The UN Global Compact has added the four fundamental ILO principles and rights at work to the ten principles of responsible business;
  - The IFC Performance Standards are used in decision-making on financing by the International Finance Corporation;
  - After the revision in 2011, the OECD Guidelines for Multinational Enterprises are entirely aligned with the UNGPs and also contain principles for supply chain responsibility;
  - The ISO 26000 guidelines recognise the importance of labour rights and good working conditions by the so-called core issue on labour practice and make various actions and expectations on a variety of related topics.[179]
  - International companies can conclude an International Framework Agreement (IFA) with an international umbrella union. In an IFA, set agreements can be established on labour conditions, working conditions, and labour rights for all employees, and sometimes also subsidiaries and suppliers of the enterprise. The international employer's organisation IOE has written papers about drafting an IFA.

- **Procurement and supply chains**

  Companies are often part of long production chains. They can monitor one another and question how they respect local and national legislation and international norms on labour rights. The requirements that companies set for their suppliers can be included in contractual agreements. The importance of this has also been recognised in the OECD Guidelines for Multinational Enterprises since its revision in 2011.

  Furthermore, the ISO 26000 guidelines recognises the importance of supply chain responsibility, because "the impacts of an organization's decisions or activities can be greatly affected by its relationships with other organizations." ISO 26000 recognizes that a companies' sphere of influence includes relationships within and beyond an organization's supply chain.[180]

  The United Nations Guiding Principles on Business and Human Rights include a due diligence process in order to identify, prevent, mitigate and account for how companies address their adverse human rights impacts. The process "should cover adverse human rights impacts that the business enterprise may cause or contribute to through its own activities, or which may be directly linked to its operations, products or services by its business relationships."[181]

Usable standard regarding labour rights and supply chain responsibility are the SA8000 Standard, the FTSE4 Good Supply Chain Labour Standards Criteria and Fair Labour Association's Workplace Code of Conduct.

*This leads to assessment elements 11 and 12.*

### 2.7.3 Assessment elements

Like other companies, financial institutions are expected to respect local, national, and international labour-related legislation and legal systems, and to endorse the four fundamental ILO principles, labour rights and the Tripartite Declaration in all their spheres of influence (as employers, in investees and in their production chains). However, the Fair Finance Guide International solely assesses the investment policy and not the staff policy of the financial institution.

The following elements are crucial for a policy regarding the companies a financial institution invests in or finances:

1. Companies uphold the freedom of association and the effective recognition of the right to collective bargaining.
2. All forms of forced and compulsory labour are unacceptable.
3. Child labour is unacceptable.
4. Discrimination in respect of employment and occupation is unacceptable.
5. Companies pay a living wage to their employees.
6. Companies apply a maximum of working hours.
7. Companies have a solid health and safety policy.
8. Companies ensure equal treatment and working conditions for migrant workers.
9. Companies have a clear management system to monitor and, if needed, correct compliance with norms on labour law.
10. Companies establish procedures on how to deal and process employee complaints and to solve violations and conflicts, preferably in consultation with the relevant trade union.
11. Companies integrate labour rights criteria in their procurement and operational policies.
12. Companies include clauses on the compliance with criteria on labour rights in their contracts with subcontractors and suppliers.

## 2.8 Nature

### 2.8.1 What is at stake?

The biological diversity of planet earth - its ecosystem diversity, species diversity and genetic diversity - forms a complex web of life that is of great importance to the economic and social development of our society, for our culture and for our leisure facilities. The accelerating decline of the global biodiversity (nature) is one of the most urgent environmental concerns. The loss of biodiversity imposes huge potential costs and risks, such as the destruction of habitats, the loss of the functions of ecosystems, the threat of the food supply and the loss of medicinal plants. The Economics of Ecosystems and Biodiversity (TEEB) project of the UNEP estimates that the loss of biodiversity due to deforestation alone will cost the world economy about USD 4,500 billion annually.[182] The care for the natural riches of the world is a moral and ethical responsibility for all mankind.

In March 2005, the Millennium Ecosystem Assessment (MEA) was published: a four-year scientific study initiated by the United Nations, in which 1,360 experts cooperated globally. A part of the study focuses on biodiversity. For this purpose, both the findings as well as the extensive recommendations for policy are published separately. The MEA findings provide insight into the current state and change of ecosystems and the respective effects on human life. The report also provides a recommendation for companies to use and preserve ecosystems in a sustainable way.

The MEA concluded: “Over the past 50 years, humans have changed ecosystems more rapidly and extensively than in any comparable period of time in human history, largely to meet rapidly growing demands for food, fresh water, timber, fibre and fuel. This has resulted in a substantial and largely irreversible loss in the diversity of life on Earth and the exacerbation of poverty for some groups of people. These problems, unless addressed, will substantially diminish the benefits that future generations obtain from ecosystems. The degradation of ecosystem services could grow significantly worse during the first half of this century.”[183] century”[184]

According to the Intergovernmental Panel on Climate Change (IPCC) "impacts from recent climate-related extremes, such as heat waves, droughts, floods, cyclones and wildfires, reveal significant vulnerability and exposure of some ecosystems and many human systems to current climate variability".[185] IPCC argues that climate change will alter the structure and functioning of most ecosystems, it will reduce biodiversity and therefore compromise the ecosystem services required by life on earth: “A large fraction of species faces increased extinction risk due to climate change during and beyond the 21st century, especially as climate change interacts with other stressors (high confidence). Most plant species cannot naturally shift their geographical ranges sufficiently fast to keep up with current and high projected rates of climate change in most landscapes; most small mammals and freshwater molluscs will not be able to keep up at the rates projected under RCP4.5 and above in flat landscapes in this century (high confidence). Future risk is indicated to be high by the observation that natural global climate change at rates lower than current anthropogenic climate change caused significant ecosystem shifts and species extinctions during the past millions of years.”[186]

According to the Partnership for European Environmental Research, *greening* the economy requires "that natural assets continue to provide the resources and ecosystem services on which our well-being relies".[187] A study of this group of European academics concluded: "transitioning to green economies is never purely based on win-win solutions, but requires taking into account potential trade-offs among multiple goals, across sectors and international leakage. The case studies indicate the need for far-sighted and multiple-source planning of funding of green economy initiatives".[188] This highlights the need for financial institutions to take into account natural assets in their financing policies.

The investment policy of financial institutions should ensure that financial institutions are only involved in investments in companies and governments that aim to prevent further loss to natural riches and also put this principle into systematic practice. When developing policies in this respect, financial institutions can make use of the international standards described in section 2.8.2.

### 2.8.2 International standards

The 1992 UN Convention on Biological Diversity (CBD) aims to globally protect and use biological diversity in a sustainable manner. The CBD demands that signatory countries include the topic of biodiversity in the legal procedures that assess the effects of activities on the environment (environmental impact assessments). Virtually all countries in the world have signed the convention.[189]

In April 2002, the signatory countries of the CBD agreed that they will "achieve by 2010 a significant reduction of the current rate of biodiversity loss at the global, regional and national level as a contribution to poverty alleviation and the benefit of all life on Earth".[190] In November 2010, the CBD achieved a new agreement, in which it was agreed that 10% of the oceans are marked as natural areas, more stringent laws have to be created to protect fish and that the amount of protected land will grow from 13% to 17%.[191]

The CBD divides biodiversity into three categories: ecosystem diversity, species diversity and genetic diversity. The specific standards that are available for each category are discussed below.

- **Protection of ecosystems and habitats**

  Various international agreements require the protection of ecosystems and natural habitats:

  - The UN Convention on Biological Diversity (CBD) demands that each member state establishes a system to preserve the biodiversity in protected areas, or ensure the protection of ecosystems in other ways.
  - The UN Convention on the Law of the Sea (UNCLOS) obliges all signatory countries to protect and preserve the biodiversity in ocean areas. The protection of specific ocean areas is dealt with in the Regional Seas Conventions, which falls under the UN Environmental Programme (UNEP). Also, the International Coral Reef Initiative focuses on specific ocean areas.
  - The biodiversity in areas that are important on environmental and cultural grounds falls under the protection of the UNESCO World Heritage Convention.
  - For *wetlands* (swamps and bogs), which are rich in biodiversity, there is the Ramsar Convention on Wetlands that ensures protection and proper management of these areas.
  - The International Union for Conservation of Nature (IUCN) has developed a system that categorises natural areas in six categories and indicates in which areas biodiversity has to be protected (category I to IV). In addition, the IUCN provides guidelines for companies on how to deal with fields that fall within these Protected Area Management Categories. In 2000, a resolution was adopted on the IUCN World Conservation Congress that calls upon all states not to allow investments in oil, gas and extractive industry projects in the protected areas (categories I to IV).

  *This leads to assessment elements 1, 2, 3 and 4.*

- **Protection of plant and animal species**

  The most obvious step for the preservation of biodiversity is the protection of endangered species of flora and fauna. A leading report of endangered species is the IUCN Red List of Threatened Species. The habitat of these endangered species is protected by the Convention on the Conservation of Migratory Species of Wild Animals (1979). This treaty also aims to restrict exploitation of areas where wild and endangered migratory animal species reside. Other global and regional conventions prohibit or restrict the commercial exploitation of whales, migratory birds, polar bears, sea turtles and seals.[192] Companies should have policies in place to avoid negative consequences to the habitats of endangered species.

  *This leads to assessment element 5.*

- **Trade in endangered species**

  The Convention on International Trade in Endangered Species of Wild Fauna and Flora (CITES) sets stringent conditions for the international trade in all endangered species with demands for national legislation from the countries that have ratified the convention. CITES applies three lists with species that are more or less threatened with extinction. Animal and plant species included in Appendix I may only be traded in exceptional situations, while the trade in species included in Appendix II is monitored to ensure that they are not endangered. Appendix III concerns species that are endangered in at least one country and where other countries are asked for help in monitoring the trade.[193]

  Companies should at least adhere to the conditions of CITES, but preferably refrain from trade in species on all appencides of the CITES list.

  Except for the protection of endangered animal species, conservation of nature requires that animal species that are not (yet) endangered are not unduly captured and that commercial catching takes place in a sustainable way. The CBD demands that countries "restore habitats and use their resources in a sustainable way to ensure species diversity".[194] This topic is also dealt with in section 3.4 on Food and section 3.5 on Forestry.

  *This leads to assessment elements 6 and 7.*

- **Protection of genetic material**

  The CBD demands that companies that want to have access to genetic material from abroad have to obtain prior permission from the exporting country and have to make clear agreements for the use of the material.

  The Bonn Guidelines are recognized as a useful first step in the implementation of relevant provisions of the CBD and are meant to assist stakeholders in developing access to genetic resources and benefit-sharing strategies. The Cartagena Protocol on Biosafety has developed a framework for the safe use of living genetically modified organisms that may have a harmful effect on biodiversity and human health and entail trans-boundary risks. The protocol also requires permission from the importing country before it is permitted to import living genetically modified organisms.

  According to Fair Finance Guide International, companies should at least comply with the relevant guidelines, but preferably refrain from involvement in living genetically modified organisms.

  *This leads to assessment elements 8, 9 and 10.*

- **Invasive alien species**

  Nature is also threatened by the intended and unintended introduction of invasive alien species. When these are outside their natural habitat, they can drive off indigenous species and take over their habitat. *Exotic invaders* can be found all over the world, but mainly pose a problem for the ecosystems of islands. Therefore, the UNCLOS and the CBD both require that member states prevent the import and introduction of alien species in order to keep it under strict control.

On 1 January 2015 the EU Regulation 1143/2014 on Invasive Alien Species entered into force. This Regulation seeks to address the problem of invasive alien species in a comprehensive manner so as to protect native biodiversity and ecosystem services, as well as to minimize and mitigate the human health or economic impacts that these species can have. Amongst others, Member States will have to draw up a list of invasive species, perform risk assessment and set up early detection measures.[195]

*This leads to assessment element 11.*

- **Water use**

Given the growing challenge of water scarcity, it is vital that companies and financial institutions become aware of their own influences on water related problems. First of all, companies should engage with stakeholders in order to learn how to avoid negative impacts and limit their water use wherever possible. However, this alone is not sufficient, commitments to improve practices are necessary. Companies should be aware of the possible negative effects their operations could have in a possible location for business operations. This should consider effects both in the short term and in the long term, in order to, for example, prevent competing with communities for water, now and in the foreseeable future. Companies should measure and calculate their water use. Furthermore, serious efforts to curb pollution of water resources and negative effects on other water users are also required. Finally, companies should be able to demonstrate that they are saving water and set goals to improve this. Various initiatives, guidelines and standards have emerged in recent years, to help companies address water risk.

Initiatives companies could participate in and learn from are:

- The UN Global Compact's CEO Water Mandate is a public-private initiative designed to assist companies in the development, implementation and disclosure of water sustainability policies and practices.
- The guidance by the UNEP and CEO Water Mandate on Corporate Water Accounting: An Analysis of Methods and Tools for Measuring Water Use and Its Impacts.
- The European Water Partnership; and
- The Water Footprint Network, which also has a standard on assessing a global water footprint.

There are several guidelines and water 'footprinting' methods as well as voluntary disclosure initiatives for calculating water use, water risk, understanding water issues and creating a sound water strategy, such as:

- The CDP's Water Program, to calculate and publish corporate water use throughout the supply chain;
- The GEMI Water Sustainability Tool; and
- The WBCSD Global Water Tool.

Alternately, the AWS International Water Stewardship Standard is a new standard, soon to be supported by a verification process. It defines a set of water stewardship criteria and indicators for how water should be stewarded at a site and catchment level in an environmentally, socially, and economically beneficial manner.

*This leads to assessment element 12 and 13.*

- **Other guidelines for companies**

The High Conservation Value (HCV) concept was initially conceived within the framework of certification of forest management and wood products (High Conservation Value Forests or HCVF), but can be applied to all ecosystems and natural living environments. The HCV Resource Network has developed national implementation guidelines, local projects, training and workshops.

In April 2006, the Voluntary Guidelines on Biodiversity-Inclusive Impact Assessments were published by the CBD. These guidelines include clear instructions on how nature criteria can be included in environmental impact assessments.

In Great Britain the EarthWatch Institute and others are working on involving companies in the preservation of biodiversity. They have drafted a road map specifically for companies, based on 10 principles of engagement, including the preparation of a strategic biodiversity plan, the integration of biodiversity standards in regular quality measurements and the protection of nature in the procurement policy. The Wildlife Trust has developed a biodiversity benchmark. Both initiatives mainly focus on companies that own land or are responsible for land management.

In December 2007, the IUCN National Committee of the Netherlands published a manual for companies, Business and Biodiversity.
The ISO 26000 guideline, published in November 2010, states that organisations behave socially responsible if they value and protect biodiversity; value, protect and restore ecological services; use land and natural resources in a sustainable way and develop areas in an environmentally responsible way.[196]

In October 2011, the Global Reporting Initiative (GRI) published a report on ecosystem services and the ways in which companies can investigate what effect they have on ecosystem services. Suggestions are made for indicators of future use in the GRIs Reporting Framework.

The International Finance Corporation's (IFC) Performance Standard 6 concerning Biodiversity Conservation and Sustainable Management of Living Natural Resources determines how companies should operate in order to avoid negative consequences on areas of high biodiversity value, including impact on natural habitats as well as endangered and endemic species. The requirements in the standard have been guided by the Convention on Biological Diversity.

The UNEP FI has introduced the Natural Capital Declaration on the Rio + 20 Earth Summit in June 2012. Signatories of this initiative will show their commitment to integrate natural capital (natural resources and the ecosystem services the earth produces from them) and criteria into their financial products.

In 1994, the Global Ecolabelling Network (GEN) was founded. This non-profit association aims to improve, promote and develop the eco-labelling of products and the creditability of eco-labelling programs worldwide. It associates third-party, environmental performance recognition and certification and labelling organizations.

A useful methodology to quantify the biodiversity impact of companies and sectors is provided by the Dutch Benchmark Biodiversity of research agency CE Delft.

Several very large companies, notably traders in the palm oil sector such as Archer Daniels Midland and Wilmar International (the latter controls roughly 45% of the global market in palm oil), have adopted 'no deforestation' policies in recent years. These policies set a high benchmark, often allowing no deforestation, no peat development and no conflicts, in their own operations or in their supply chain. Although in these first cases directed at the palm oil sector, financial institution may apply the policies to other sectors causing deforestation, peat loss and conflicts as well.[197]

*This leads to assessment elements 14, 15 and 16.*

### 2.8.3 Assessment elements

Financial institutions can influence the protection of nature, especially if they invest in or finance industries with a potentially large influence on nature, such as forestry, the extractive industry, the oil and gas industry, fishery, water supply and infrastructure and industries that make use of genetic material, such as agriculture, biotechnology, the medical industry and the cosmetic industry.

For companies there are various grounds for putting biodiversity high on the agenda. This includes more stringent rules to protect ecosystems and more stringent supervision, increased costs in product chains that depend on certain ecosystems, changes in consumption patterns and pressure from society and social organisations. Moreover, new commercial chances for companies arise in situations where commerce and nature management go hand in hand. Financial institutions can capitalise on this development.[198]

In order to address the risks for natural areas and other threats to biodiversity, financial institutions have to draft an investment policy in line with international conventions and national legislation.

The following elements are crucial for a policy regarding the companies a financial institution invests in or finances:

1. Companies prevent deforestation and protect natural forests including old growth forests, bogs, mangroves and rainforests, as described in the High Conservation Value (HCV) concept.
2. Companies prevent negative impact on protected areas that fall under the categories I-IV of the International Union for Conservation of Nature (IUCN).
3. Companies prevent negative impact on UNESCO World Heritage sites.
4. Companies prevent negative impact on protected areas that fall under the Ramsar Convention on Wetlands.
5. Companies prevent negative consequences for the populations or the number of animal species that are on the IUCN Red List of Threatened Species.
6. Trade in endangered plant and animal species complies with the CITES conditions.
7. Trade in endangered plant and animal species that are on the CITES lists is unacceptable.
8. Activities in the field of genetic materials and genetic engineering only take place if they meet the permission and processing requirements as described in the UN Convention on Biological Diversity and the related Bonn Guidelines or Nagoya Protocol.
9. Production of, or trade in, living genetically modified organisms can only take place if permission has been obtained from the importing country and all requirements of the Cartagena Protocol have been met.
10. Production of, or trade in, living genetically modified organisms is unacceptable.
11. Companies prevent the introduction of invasive alien species in ecosystems.
12. Companies conduct water scarcity impact assessments and prevent negative impacts in water scarce regions.

13. Companies do not start new operations in areas where water scarcity is pre-existing and operations would compete with the needs of communities.
14. Companies make an environmental impact assessment on the total consequences of a large scale project on biodiversity, at least according to the guidelines for reporting on biodiversity and land use in the Global Reporting Initiative.
15. Companies integrate criteria on nature into their procurement and operational policies.
16. Companies include clauses on the compliance with criteria on nature in their contracts with subcontractors and suppliers.

## 2.9 Tax

### 2.9.1 What is at stake?

For each democratic society, tax revenues are essential to finance public provisions such as health care, education, infrastructure and social security. Research shows that a fair system of taxation contributes more to the development of a healthy, democratic society than revenues from development aid or from the export of raw materials. As in order to raise taxes, the development of a capable and reliable civil service is required, while conversely civilians that have to pay tax expect a lot more of, and are more involved with, the public administration. Democratisation is often the result of striving for higher tax revenues.[199]

Also, companies benefit from the public provisions in the countries where they operate and therefore have responsibility to pay tax in every country and to be open about it. Yet, a lot of international operating financial institutions, companies and rich private clients benefit from international differences in tax percentages and loop holes in national tax legislation to significantly reduce their overall tax burden (tax planning).[200]

Thereby, they often make use of shell companies in tax havens that are not only known for their low tax rates but also for their lack of financial transparency. How much tax is ultimately paid, and in which country, quickly eludes everybody. A lot of international financial institutions have branches in tax havens to help their clients *and* to limit their own tax payments. If these type of constructions violate the law, this is called tax evasion, but even if this is not the case - in case of tax avoidance - this type of behaviour is contrary to the Corporate Social Responsibility principles: it is socially irresponsible to deprive governments of the revenues they need to develop their country socially and economically.[201]

The Tax Justice Network (TJN) estimated in 2012 that the ‘super rich’ have channelled between USD 21 and USD 32 billion of untaxed capital to tax havens.[202] In addition, TJN also estimated that in 2012 US multinationals alone shifted between USD 500 and USD 700 billion of revenues, "mostly to countries where these profits are not taxed, or taxed at very low rates".[203]

Furthermore, multinational enterprises (MNEs) often lack transparency on tax payments. Oxfam calculates that developing countries annually lose more than USD 100 billion in tax revenues through tax evasion and avoidance by companies.[204] A 2014 report of IMF explored the "broader macroeconomic and development impact of corporate tax spill overs, including wider issues of tax competition between national governments". The IMF argues that national tax laws and international tax arrangements should be transformed to prevent base erosion and profit shifting (BEPS). "Our technical assistance work in developing countries frequently encounters large revenue losses through gaps and weaknesses in the international tax regime", the IMF argues. Relative to all tax revenues, this can be up to 10-15 percent.[205] The IMF has indicated that developing countries are more vulnerable to BEPS activities of multinational companies than OECD countries.[206]

The annual USD 100 billion developing countries' governments lose due to tax avoidance by MNEs, is more than the amount that developing countries, according to the United Nations Sustainable Development Goals, need to install a global safety net to eradicate extreme poverty in all countries.[207] It also corresponds with the OECD estimation that developing countries annually lose more than three times the development aid received to tax revenues in tax havens.[208]

One can expect from responsibly operating financial institutions that they do not deliberately assist clients in avoiding taxes and that they do not avoid taxes themselves. Moreover, financial institutions have the responsibility to only grant financial services to companies that pay the taxes owed in the countries where they operate. When developing policies on taxes, financial institutions can make use of the international standards described below.

### 2.9.2 International standards

The most important international standards in the field of tax are summarized below.

- **Harmful tax practices by governments**

  Tax havens are often very small countries that almost entirely depend of the revenues from activities related to tax avoidance and tax evasion.[209] In 2015 the European Commission published its first list of international tax havens. The list contains third countries listed by Member States for tax purposes. The list does therefore not make use of a defined set of criteria and does not give sufficient guidance in defining tax havens. The list is updated annually.[210]

  Countries with harmful preferential tax regimes try to lure corporate investments offering fiscal advantages to certain groups of companies. These measures stimulate tax avoidance by multinational corporations and decrease the tax revenues of other states.[211] The OECD monitors countries within the Global Forum on Transparency and Exchange of Information for Tax Purposes. To this effect, OECD and non-OECD countries cooperate in the implementation of an internationally accepted standard for taxes.[212] However, civil society organisations have outlined several weaknesses of the Global Forum process and called for a more inclusive process under the auspices of the UN.[213]

  In 2015, the Tax Justice Network published its latest Financial Secrecy Index, on which 102 locations or so-called global *secrecy jurisdictions* have been identified and listed by their level of transparency. The term ‘secrecy jurisdictions’ can be interchanged with the term tax haven, but emphasizes suspension from disclosure (of information). Tax Justice Network furthermore recognizes the large amount of illicit financial flows in poor countries, but at the same time recalls ‘the other side of the coin’, namely ‘those jurisdictions that encourage and facilitate illicit financial flows, by providing an environment of secrecy that allows these outflows to remain hidden, and largely untaxed. Contrary to OECD, Tax Justice Network has not suspended its list of secrecy jurisdictions’.[214]

  In November 2013 the European Commission has introduced new regulations for the corporation tax which parent companies and their subsidiaries have to pay, in order to try to close the loopholes of the law. This is the reason why it is no longer allowed to make use of the so-called ‘double non-taxation’. Due to double non-taxation “it could occur that a subsidiary receives tax deduction, and the parent company receives an exempt in another country. The net result is that the company pays very little or no tax at all over the profits the subsidiaries have made”. With these regulations multinationals should be no longer able to take advantage of differences in tax regulations.[215]

However, Oxfam Novib argues that even the 2016 reform proposal of the European Commission, the Anti Tax Avoidance Package will not be sufficient to deal with tax avoidance by MNEs. The proposed regulations aim to address profit shifting by MNEs to subsidiaries in low-tax jurisdictions, but only when these subsidiaries pay less than 4% corporate income tax. Also, MNEs can easily move their headquarters to a country outside the EU to completely avoid these regulations.[216] Oxfam International calls for greater fiscal justice in the European Union by policy changes and procedural reforms.[217] Eurodad argues that the proposals can even lead to lower taxation of MNEs.[218] Companies should therefore publish information about their group structure and the activities of its subsidiaries in low-tax jurisdictions, as this will allow companies to "be able to positively justify the retention of assets, income and activities in low-tax or secrecy jurisdictions".[219]

If a company is involved in a adjudication or arbitration case regarding a tax dispute, it should publish information on this dispute, Christian Aid, Oxfam and ActionAid argue: "Resolving unsettled disputes between corporate taxpayers and tax authorities increasingly happens outside court settings, particularly where it involves more than one tax authority and the taxpayer invokes the growing number of arbitration clauses in tax treaties. While there may be advantages to arbitration, as with tax settlements, a key challenge it presents is a potential lack of accountability about how both taxpayer and tax authorities have behaved over disputes often involving millions of dollars of tax revenues (especially in the case of transfer pricing disputes). A voluntary commitment to publishing the results of arbitration, where it is used as an alternative to court, would compensate for this potential accountability deficit and help to build the reputation of a company among its stakeholders as a transparent and responsible taxpayer".[220]

*This leads to assessment elements 1, 4, 7, 8, 9, 10, 14 and 15.*

- **Tax planning by multinational companies**

The OECD Guidelines for Multinational Enterprises offer a tool for codes of conduct of companies on how to deal with social issues. On taxes, the guidelines mention that "It is important that enterprises contribute to the public finances of host countries by making timely payment of their tax liabilities. In particular, enterprises should comply with both the letter and spirit of the tax laws and regulations of the countries in which they operate. Complying with the spirit of the law means discerning and following the intention of the legislature."

UNCTAD argues that offshore investment hubs play a major role in tax avoidance. UNCTAD proposes ten Guidelines for Coherent International Tax and Investment Policies, which include the following key objectives to address tax avoidance:

- removal of aggressive tax planning opportunities as investment promotion levers;
- mitigation of the impact on investment of tax avoidance measures;
- recognition of shared responsibilities between investor host, home and conduit countries and the consequent need for a partnership approach; acknowledgement of links between international investment and tax agreements;
- and understanding of the role of both investment and fiscal revenues in sustainable development and of the capabilities in developing countries to address tax avoidance issues.

In 2015 the UN PRI has drafted an Engagement Guidance on Corporate Tax Responsibility, providing guidance to investors on why and how to engage with investees involved in tax planning. The UN PRI argues tax planning risks for investors can be severe and cover a large number of portfolio companies. Aggressive corporate tax planning can:[221]

- create earnings risk and lead to governance problems;
- damage reputation and brand value;
- cause macroeconomic and societal distortions.

Furthermore, financial institutions and other companies should be transparent about the company-specific tax-rulings they have agreed with governments. In a 2015 paper on responsible tax conduct of companies, civil society organizations (CSOs) ActionAid, Christian Aid and Oxfam International argued: “Like tax incentives and tax holidays, discretionary or company-specific tax rulings can form the basis for tax avoidance and otherwise undermine the tax base of other countries without the tax advantage being apparent to other revenue authorities or to the public. The EU is developing a framework for such rulings to be automatically transmitted to other jurisdictions, and the Netherlands has considered doing so with developing countries through its tax treaty network”. A framework to transmit rulings to other jurisdictions is not sufficient to be transparent. The CSOs argue that “in line with the general principle that tax-responsible companies will be able to justify the key determinants of their tax position to public stakeholders as well as to revenue authorities, a tax-responsible company should be able to publish such rulings”.[222]

*This leads to assessment elements 4, 7, 6, 8, 12 and 13.*

- **Country-by-Country reporting**

There have been various other steps to improve the *Country-by-Country (CbC)* reporting of multinational companies. CbC reporting makes it possible to determine how much taxes and other payments are made by companies to governments and to which extent companies relocate revenues to other countries to avoid or evade tax payment.

In the G4 Sustainability Reporting Guidelines of the Global Reporting Initiative (GRI) the breakdown of tax payments per country is also included. *Economic Performance Indicator EC1* asks companies to report on the “Direct economic value generated and distributed, including revenues, operating costs, employee compensation, donations and other community investments, retained earnings, and payments to capital providers and governments.” In this last category it is requested to report on: “all company taxes and related penalties paid at the international, national, and local levels. (..) Report taxes paid by country for organisations operating in more than one country.”

During the G20 conference in Moscow in July 2013 the OECD presented an Action Plan on Base Erosion and Profit Shifting (BEPS), resulting in a 2015 report introducing fifteen guidelines for modernising tax systems and to prevent tax avoidance by multinationals.[223]

In 2015 the OECD published a Country-By-Country Reporting Implementation Package, containing a model legislation for reporting of country-by-country data on tax, profits, other key financials and employment to tax authorities. These data are considered key to assess tax risks. However, the OECD system involves confidential reporting to a home country tax authority only, followed by exchange of information between tax authorities.. The Action Plan is backed up by several institutional investors, calling for governments to install tax reforms: "As international investors, ensuring sound governance practices are embedded in corporate activities, including taxation planning and associated reporting and disclosure mechanisms is a fundamental concern. [224] Civil society organisations have however criticised the OECD BEPS process, among other things for its lack of inclusion of developing countries.[225]

The EU introduced five key areas for action for A Fair and Efficient Corporate Tax System in the European Union. The action plan includes “assessing whether additional disclosure obligations of certain corporate tax information should be introduced”.[226]

The EU already adopted the EU Capital Requirements Directive IV (2013/36/EU) in 2013, which applies to credit institutions and investment firms with their residence in one or more of the EU Member States. This obliges financial institutions to provide full Country-by-Country (CbC) reporting on the following topics:[227]

- name(s), nature of activities and geographical location
- turnover
- number of employees on a full time equivalent basis
- profit or loss before tax
- tax on profit or loss
- public subsidies received

Reporting on the first three topics should be made available from July 2014 onwards, while reporting on all topics should be made available from January 2015 onwards. Some banks, such as ING Bank, also provide other relevant data per country, such as total assets.[228]

However, organisations such as the Tax Justice Network and Eurodad believe that public country-by-country reporting should not be restricted to specific industries, but should apply to all companies operating in more than one country. This statement was endorsed in June 2011 by the Dutch House of Representatives by means of an accepted motion.[229] In September 2012, the European Parliament and the tax services of Canada, France, Great Britain and South Africa also spoke in favour of this principle.[230] Responding to this call, the EU will conclude an impact assessment and public consultation on corporate tax transparency in the first quarter of 2016.[231]

*This leads to assessment elements 1, 3 and 9.*

- **Procurement and supply chains**

Companies are often part of long production chains. They can monitor one another and question how they respect local and national legislation and international norms on tax. The requirements that companies set for their suppliers can be included in contractual agreements. The importance of this also recognised in the OECD Guidelines for Multinational Enterprises since its revision in 2011.

Also the ISO 26000 guideline recognises the importance of supply chain responsibility, because “the impacts of an organization's decisions or activities can be greatly affected by its relationships with other organizations.” A companies’ sphere of influence includes relationships within and beyond an organization’s supply chain.[232]

*This leads to assessment elements 16 and 17.*

### 2.9.3 Assessment elements

For financial institutions, the issue of taxes is relevant in three ways. Primarily, international financial institutions are multinational corporations themselves and therefore they have to pay the owed taxes by the letter of the law as well as in the spirit of the countries in which they operate. Financial institutions can be expected to be transparent in their tax payments.

Secondly, virtually all financial services that financial institutions grant to companies and rich private clients have a tax component. Because large amounts are involved in business loans, financing projects and investments, tax planning can often result in significant savings for clients. Thirdly, taxes is an issue on which financial institutions should assess all their investees, even if the financial institution does not actively cooperate with tax avoidance of the company.

The following elements are crucial for a policy regarding the financial institution's internal operations:

1. For the most important countries in which the financial institution operates, it reports country-by-country on its revenues, profit, FTEs, subsidies received from governments and tax payments to governments.'
2. For each country in which the financial institution operates, it reports country-by-country on its revenues, profit, FTEs, subsidies received from governments and tax payments to governments.
3. For each country in which the financial institution operates, it reports country-by-country on its total assets.
4. The financial institution does not advise clients to set up international structures with the main purpose to avoid or evade taxes.
5. The financial institution does not participate in transactions with international structures of which the main purpose is to avoid or evade taxes.
6. The financial institution publishes any company-specific tax rulings it has obtained from tax authorities.
7. The financial institution does not own subsidiaries nor associates in tax havens, unless the subsidiary or associate has substance and undertakes local economic activities.
8. The financial institution does not provide financial services to companies in tax havens, unless the company has substance and undertakes local economic activities.

The following elements are crucial for a policy regarding the companies a financial institution invests in or finances:

9. Companies publish their full group structure, including indirectly and jointly-owned entities.
10. Companies publish an explanation of the activities, functions and ultimate shareholder of every subsidiary, branch, joint venture or related party located in a low-tax jurisdiction.
11. For each country in which companies operate, they report country-by-country on their revenues, profit, FTEs, subsidies received from governments and payments to governments (e.g. withholding taxes, payments for concessions and company tax).
12. Companies focus their international enterprise structure and their international transactions in a way that reflects the economic substance of the activities and transactions undertaken, without any steps made primarily to secure a tax advantage.
13. Companies publish any company-specific tax rulings it has obtained from tax authorities.
14. Companies make public, to the extent legally and practically possible, the decision of any adjudication or arbitration to which it, or any of its subsidiaries, is a party, undertaken to resolve a tax dispute, whether in a court or in an arbitration setting.
15. Companies have a management system which results in immediate actions if suspicions arise that employees or suppliers are guilty of facilitating tax evasion.
16. Companies integrate criteria on tax in their procurement policies and operational policies.
17. Companies include clauses on the compliance with criteria on tax in their contracts with subcontractors and suppliers.

# Chapter 3 Sector themes

## 3.1 Arms

### 3.1.1 What is at stake?

Arms can kill, maim and destroy. Therefore, they are a threat to the most fundamental human right: the right to life. Arms are deployed in wars and armed conflicts between and within states, by government forces as well as armed groups that do not belong to a state (also known as non-state actors). Armed conflicts threaten the safety of millions of people around the world. Moreover, small arms are not only used in armed conflicts but also in conflicts between individuals, within families and between groups and gangs. Nowadays, there are about 875 million small arms in circulation.[233]

States have the right - and indeed the obligation - to protect their citizens and individually or collectively defend security interests. States' responsibilities towards public security include regulating, checking and monitoring the manufacture, transfer, possession, stockpiling and use of arms. Yet, in practice there has been a lack of expediency to governments and multilateral bodies (such as the United Nations Security Council) to monitor the international arms trade. Civil society research reports show how the arms industry, despite existing regulatory regimes, continues to sell arms to human rights abusing regimes and conflict zones.[234]

In 2014, total global military expenditure had an estimated value of EUR 1,460 billion. On average, military expenditure was about 2.3% of the Gross National Product (GNP). The United States spending of EUR 501 billion accounted for 34% of global military expenditure, followed at a large distance by China (12%), Russia (4.8%), Saudi Arabia (4.5%), and France (3.5%). Military spending grew the most in Central America and the Caribbean (9.1%), North Africa (7.6%), and Eastern Europe (8.4%).[235]

There seems to be a relationship between military expenditure and the socio-economic development of poor countries. Globally, military expenditure counts for about 9% of total public spending. In developing countries - where there is a large need for investments in agriculture and food, education, health care and infrastructure - military expenditure is often a significant barrier to reaching the Sustainable Development Goals (SDGs).[236] According to the 2014 figures of the SIPRI Military Expenditure Database, Yemen (23.9%), Myanmar (13%) and Angola (12.5%) are examples of developing countries that spent a significant amount of their total government budget on military material.[237]

The harmful effect of military expenditure on human development is further aggravated by debts made for purchasing military equipment. An estimated 15 to 20 percent of global indebtedness is related to military spending. In many developing countries, interest payments on military debts surpass the expenditures on health care and education.[238]

Perhaps more than any other legal trade, international arms trade is also strongly connected to corruption.[239] Despite the fact that arms trade only constitutes for 1% of global trade, studies by SIPRI suggest that corruption in the arms trade contributes roughly to 40% of all corruption in global transactions.[240] Transparency International estimates that corruption in the arms trade leads to a loss of USD 20 billion annually, which is equivalent to the total sum pledged by the G8 in L'Aquila in 2009 to fight world hunger.[241] A large part of arms exports goes to developing countries and emerging economies[242] and through corruption, public funds are diverted from spending on economic and social development and may end up fueling conflict.

The industry needs to be thoroughly and structurally reformed to ensure, as a minimum, that:

- No arms are produced which do not distinguish between combatants and non-combatants (i.e. which violate International Humanitarian Law);
- Arms are not supplied to repressive regimes, fragile states, and non-state actors;
- Corruption is eliminated and transparency in reporting is improved;
- Products and services supplied/sold do not affect the sustainable development of poor countries.

As long as these structural changes do not occur in the arms industry, investing in this industry imposes large corporate social responsibility (CSR) risks. Financial institutions could finance or invest in companies that are involved in corrupt practices or in trade with oppressive regimes. Hence, it is of great importance that financial institutions implement a policy for this industry that is based on the international standards described below.

### 3.1.2 International standards

The most important international standards relevant to arms and arms transfers are summed up below.

- **International humanitarian law**

  International Humanitarian Law (IHL) is a collection of leading international agreements that constitute the rules concerning armed conflicts. The objective of IHL is to limit civilian suffering from armed conflicts. It protects people who do not participate in hostilities and limits the means and methods of warfare. An important principle is that distinction has to be made during warfare (including with the use of arms) between soldiers and civilians: civilians should not be a target in warfare.[243]

  *This leads to assessment elements 1, 2, 3, 4, 5 and 6.*

- **Specific weapon systems**

  There are various international conventions that concern the production, the use, the storage, and the trade of specific weapon systems:

  - The 1970 Nuclear Non-proliferation Treaty (NPT) aims to prevent the spread of nuclear arms.
  - The 1975 Biological and Toxin Weapons Convention (BWC) prohibits the use of biological and toxin weapons.
  - The 1980 Convention on Certain Conventional Weapons (CCW) aims to ban or restrict the use of weapons that are considered to cause to cause unnecessary or unjustifiable suffering to combatants or to affect civilians indiscriminately.
  - The 1997 Chemical Weapons Convention (CWC) prohibits chemical arms.
  - The 1997 Mine Ban Treaty prohibits anti-personnel landmines.
  - The 2008 Convention on Cluster Munitions (CCM) bans cluster munitions.

  International conventions and national legislation on arms rarely explicitly include prohibitions on financial investments. However, civil society organisations and a growing group of states interpret investments in cluster munitions as banned under the Convention on Cluster Munitions. [244] Article 1 (1) c of this convention reads: “Each State Party undertakes never under any circumstances to assist, encourage or induce, in any way, anyone to engage in any activity prohibited to a State Party under this Convention.”

An increasing group of countries has expressed that article 1.1c, according to their understanding, also includes a ban on financial assistance. Australia, Bosnia and Herzegovina, Cameroon, Canada, Colombia, Congo DR, the Republic of Congo, Costa Rica, Croatia, the Czech Republic, France, Ghana, Guatemala, the Holy See, Hungary, Lao PDR, Lebanon, Madagascar, Malawi, Malta, Mexico, Niger, Norway, Rwanda, Senegal, Slovenia, the United Kingdom and Zambia have all said to interpret the article in such a way that investments in cluster munitions are or can be seen as prohibited under the convention. Belgium, Ireland, Italy, Liechtenstein, Luxembourg, the Netherlands, New Zealand, Samoa, Spain and Switzerland have adopted laws to prohibit (different kinds of) investments in cluster munitions. Denmark has announced to investigate a ban on investments in land mines, antipersonnel mines and cluster munitions.[245]

*This leads to assessment elements 1, 2, 3, 4, 5 and 6.*

- **International arms trade**

It is of course never allowed to supply arms to countries on which an embargo is imposed. Besides, supplying arms to countries where people lack basic freedoms or where armed conflicts rage, is undesirable. Likewise, in countries most receptive to corruption, in fragile states, or where a relatively high share of public spending is for the military, there is a serious risk that delivering arms enhances violations of human rights and/or contribute to creating more poverty.[246]

There are various initiatives to regulate arms trade in order to, for instance, prevent arms from being delivered to repressive regimes or countries in conflict.

Organisations such as the United Nations Security Council and other multilateral organisations have the (international) authority to establish arms embargoes against certain countries or armed troops. Mostly, embargoes are established following involvement in conflicts involving serious violations of human rights.[xiv]

Some arms embargoes are partial in nature. For example, the EU embargo against China is understood to ban the export of “lethal” goods[247], whereas the only politically binding EU embargo against Egypt relates to goods that might be used for internal repression.[248] This research does not make such distinctions, because in most cases, transferring arms to countries under a partial embargo means supporting repressive regimes.

Other embargoes only apply to so-called non-government forces (NGF’s). In this research, the countries’ territories, within which the NGF’s under an embargo operate, are also considered controversial with regard to arms trade. These countries should by definition be considered as weak or fragile states, as the government does not have a monopoly on the use of violence within its own territory. Consequently, it is not uncommon that arms supplied to government forces of fragile states end up with NGF’s.[249]

*This leads to the assessment element 8.*

[xiv] For an extensive up-to-date overview, see SIPRI’s Arms Embargoes Database: http://www.sipri.org/databases/embargoes.

- **Human rights law and international humanitarian law**

  The Arms Trade Treaty (ATT) is a multilateral treaty that regulates the international trade in conventional arms. It was adopted on 2 April 2013 by the General Assembly of the United Nations with a large majority of votes. After obtaining the required 50 ratifications, the treaty entered into force on 24 December 2014.[250] The ATT describes how it regulates the conventional weapons trade: "At the heart of the ATT is the obligation on countries that have joined it to make an assessment of how the weapons they want to transfer will be used. They must determine if the arms would commit or facilitate genocide, crimes against humanity, war crimes and serious human rights violations. Each state must assess if there is an overriding risk that a proposed arms export to another country will be used for or contribute to serious human rights abuses. If so, those arms must not be sent. [...] The Treaty [also] sets out guidelines for states that are importing weapons, and requires importers and exporters to cooperate in sharing information necessary to make the above assessment. It also includes obligations for countries that have weapons transiting through their borders and for brokering activities. [...] The Treaty covers conventional weapons (meaning not nuclear, chemical or biological). The arms specifically mentioned in the Treaty are battle tanks, armoured combat vehicles, large-caliber artillery systems, combat aircraft, attack helicopters, warships, missiles and missile launchers and small arms and light weapons. Ammunition, as well as the parts and components that make up weapons systems, also fall under its regulation".[251] The treaty is open to additional regulations on future military technologies.[252]

  During the process of drafting and negotiating the ATT, Amnesty International has insisted on including the so-called Golden Rule on Human Rights and Humanitarian Law in the ATT. The Golden Rule specifies that “all governments must avoid trade in arms - also military arms, munitions and gear - when there is a substantial risk that the weapons be used for severe violations of international human rights and humanitarian rights.”[253] In the ATT the term *overriding risk* has been chosen for the aforementioned *substantial* risk. Taken into account that the humanitarian principles that form the basis of the ATT, this means -according to the Control Arms Campaign- that states are not allowed to export in case of a ‘substantial or clear’ risk of the arms being used for violations of human or humanitarian rights.[254]

  *This leads to the assessment elements 9 and 10.*

- **Controversial arms trade**

  The EU has also recognized the need for a system to control arms transfers. Its 2008 Common Position “defining common rules governing control of exports of military technology and equipment” contains eight criteria, aimed at, among others, preventing military exports likely to be used in the country of final destination for internal repression, in internal or international conflicts. The EU arms export policy also contains measures to facilitate implementation by the member states and improve cooperation between the member states. The EU criteria are summarized below:[255]

  - Respect for international commitments of Member States, in particular sanctions decreed by the UN Security Council and the EU, as well as agreements on non-proliferation and other international obligations;
  - The respect of human rights and international humanitarian law in the country of destination;
  - The internal situation in the country of final destination, as a function of the existence of tensions or armed conflicts;
  - Preservation of regional peace, security and stability;

- The national security of the Member States and of territories whose external relations are the responsibility of a Member State, as well as that of friendly and allied countries;
- The behaviour of the buyer country with regard to the international community, as regards in particular its attitude to terrorism, the nature of its alliances and respect for international law;
- The risk that equipment will be diverted within the buyer country or re-exported under undesirable conditions;
- The compatibility of the arms exports with the technical and economic capacity of the recipient country, taking into account the desirability that states should achieve their legitimate needs of security and defence with the least diversion for armaments of human and economic resources, e.g. through considering the recipient country's relative levels of military and social spending.

The EU Common Military List should be used to define if a product should be considered as military equipment. Equipment that can be used for both civilian and military applications, should be considered as military equipment when they have a non-civilian purpose.

*This leads to the assessment element 7.*

Several lists and initiatives can serve to illustrate positions of countries relating to issues covered by these criteria:

- Most of the countries where people lack freedom can be looked up in the index of the Freedom House. This is an independent American non-profit organisation that ever since 1941 has stood up for democracy and freedom all over the world. The Freedom House annually publishes "Freedom in the World". This publication assesses 195 countries and 14 related and disputed territories with regard to Political Rights and Civil Rights.

  In addition, the Economist's Democracy Index provides a snapshot of the state of democracy worldwide for 165 independent states and two territories. This covers almost the entire population of the world and the vast majority of the world's states (micro states are excluded). The Democracy Index is based on five categories:[256]

  - electoral process and pluralism;
  - civil liberties;
  - the functioning of government;
  - political participation; and
  - political culture.

Countries are placed within one of four types of regimes: full democracies, flawed democracies, hybrid regimes, and authoritarian regimes.

- Countries that have been caught up in armed conflicts are ranked in the Uppsala Conflict Data Program. Also The Global Peace Index of Vision of Humanity, an Australian research institute, is a useful tool. It assesses the extent to which countries live in peace or are caught up in conflicts, using 23 indicators.
- The Government Defence Anti-Corruption Index Corruption Perception Index of Transparency International is the first global analysis of corruption risk within military establishments worldwide. It assesses and compares levels of corruption risk and vulnerability across countries.

- The Fragile States Index can be used for identifying fragile states. This Index is published by Foreign Policy, an American magazine and the Fund for Peace, an American research institute. The Fragile States Index assesses 178 states, using 12 social, economic, political and military indicators in order to indicate which states are most vulnerable to violent internal conflicts and social decline.
- In order to indicate which countries spend a great part of their government budget on arms the publications of the Stockholm International Peace Research Institute (SIPRI) may be used. SIPRI is an independent Swedish research institute for peace and security. Among many others things, they publish data on levels of relative military spending.

*This leads to the assessment elements 11, 12, 13 and 14.*

- **Exceptions for certain types of investments or activities**

  The policy of a financial institution should not include exceptions for certain types of investment, financing and/or asset classes of the financial institution. Furthermore, the policy should not include exceptions for activities or projects that are not related to the production of weapons.

  *This leads to the assessment elements 15 and 16.*

### 3.1.3 Assessment elements

Even more so than in other sectors, financial institutions have to carefully consider their investments in arms manufacturers and traders. First of all, because it concerns lethal products with potentially devastating effects, but also because the industry is hardly transparent and has a history of corruption and violations of the law. With outstanding loans and/or investments in this industry, financial institutions can get involved in transactions related to very serious violations of human rights, armed conflicts, corruption, and the production of controversial or banned weapons.

The following elements are crucial for a policy regarding the companies a financial institution invests in or finances:

1. Production of, maintenance of, and trade in anti-personal landmines, including important parts of landmines, is unacceptable.
2. Production of, maintenance of, and trade in cluster munitions, including important parts of cluster munitions, is unacceptable.
3. Production of, maintenance of, and trade in nuclear weapons, including important parts of nuclear weapons, in or to countries that have not ratified the Non-proliferation Treaty is unacceptable.
4. Production of, maintenance of, and trade in nuclear weapons, including important parts of nuclear weapons, is unacceptable.
5. Production of, maintenance of, and trade in chemical weapons, including important parts of chemical weapons, is unacceptable.
6. Production of, maintenance of, and trade in biological weapons, including important parts of biological weapons, is unacceptable.
7. Goods that are essential for military purposes, but can also be used for civilian products (‘dual-use’ goods), are considered as military goods when they have a non-civilian purpose.
8. Supply of arms and weapon systems, military transport systems, and other military goods to countries that are under a United Nations or relevant multilateral arms embargo, is unacceptable.

9. Supply of arms and weapon systems, military transport systems, and other military goods is unacceptable if there is an overriding risk that the arms will be used for serious violation of international human rights and humanitarian rights.
10. Supply of arms and weapon systems, military transport systems, and other military goods to countries that violate human rights, is unacceptable.
11. Supply of arms and weapon systems, military transport systems, and other military goods to conflict areas or war zones, is unacceptable.
12. Supply of arms and weapon systems, military transport systems, and other military goods to countries that are sensitive to corruption, is unacceptable.
13. Supply of arms and weapon systems, military transport systems, and other military goods to countries having a failed or fragile state, is unacceptable.
14. Supply of arms and weapon systems, military transport systems, and other military goods to countries that spend a disproportionate part of their budget on purchases of arms, is unacceptable.
15. The policy does not mention exceptions for certain types of investment, financing and/or asset classes of the financial institution.
16. The policy does not mention exceptions for activities or projects that are not related to the production of weapons.

## 3.2 Financial sector

### 3.2.1 What is at stake?

In an increasingly globalised world, financial institutions play a crucial role in the global division of financial means. Most governments and companies depend on financial institutions to invest and to provide products and services. The investments of financial institutions take place in a global marketplace where their monies can be deployed in all industries and on all continents in virtually any social activity, including financial institutions that only have offices in their own country.

This ubiquity creates opportunities and risks. Because their monies are deployed in all corners of the world, financial institutions are in a unique position to play a role in the social changes that are necessary to enable a sustainable and socially just future. They can invest in or finance new products and production processes with which energy is saved and sustainable energy provision is encouraged, with which income and development opportunities are offered in developing countries or with which millions of people can get access to health care. In order to reach all of the Sustainable Development Goals (SDG), which seek to halve world poverty before 2015, an active role for financial institutions is indispensable. The 2016 publication of UNEP and the Institute for Human Rights and Business, Human Rights and Sustainable Finance, states: "the international human rights framework is an integral part of defining the purpose of the financial system in serving society. The framework calls for the financial system at systemic, client, and consumer levels to avoid harming people’s rights, make finance accessible to all, and create innovative financial policies, regulations, products, and services to help build a resilient economy and society".[257]

However, this important role also has a downside: often investments by financial institutions are used for activities that harm the environment, human rights and development opportunities. There are countless examples of financial institutions that, often without sufficiently realising it, enable large-scale deforestation with their monies, as well as the construction of polluting mines, supplying arms to oppressive regimes and factories where labour rights are violated. Also, the credit crisis shows that many financial institutions have been led by purely financial motives, where they have neglected assessing the risks of their investments - for the financial institution itself, but also for society.

Many governments and banking regulators are currently launching guidelines and initiatives to push the banks in their country to invest more responsibly. Internationally, the Sustainable Banking Network (created by IFC) forms a group of banking regulators and associations that are interested in sustainable banking policies, guidelines and practices and collective learning of its members. To promote the integration of sustainability in investment practices in the financial sector, in 2016 UNEP FI, PRI and the Generation Foundation have launched a three year programme to integrate sustainability into investors' fiduciary duties. The goal of the project is "to mobilise investors to uphold the full remit of fiduciary duty and take full account of material sustainability factors in investment practices".[258]

From the report Environmental and Social Risk Due Diligence in the Financial Sector (which was made on request by the Dutch government in 2013), it becomes clear that financial institutions increasingly establish sustainability conditions for the companies and governments in which they invest. Similar initiatives are visible through China's Green Credit Guidelines, Indonesia's Sustainable Finance Roadmap and Brazil's ESRSM.

Complementary to this, financial institutions should also set conditions to the loans they supply to other financial institutions, to prevent that, via a detour, their monies still end up at the companies and governments in which they do not want to invest. The investment policy of financial institutions should ensure that financial institutions only lend money to other financial institutions that also take their social responsibilities seriously. When developing policies for this industry, financial institutions can make use of the international standards described below.

### 3.2.2 International standards

In recent years, a number of international standards have been established for the financial sector:

- **Business operations**

  As for other international companies, financial institutions may be expected to comply with general guidelines for responsible business operations in their relations with employees, clients, governments, and the wider society. The most well-known examples are the UN Global Compact, which formulates ten principles of responsible business, the OECD Guidelines for Multinational Enterprises, in which a wide range of social and environmental topics are addressed and ISO 26000, in which the social responsibility of organisations is described in 7 principles and 7 core issues.

  Also sustainability reporting is important. The GRI framework, including the Financial Services Sector Disclosure, may, amongst others, be used for such reporting. For small and medium enterprises (SMEs), less elaborate sustainability reporting is required. SMEs can report on the GRI indicators that are relevant to their operations, for example by following the High5! Approach.

  *This leads to assessment elements 1, 2, 5, 6, 13 and 14.*

- **Management of social and environmental risks**

  There are various guidelines that stimulate financial institutions to pay more attention to the possible social and environmental risks of their investments. Led by the United Nations Environmental Programme, in 1992 the UNEP Finance Initiative (UNEP FI) has been established. By now, more than 200 banks, insurance companies and other financial institutions from all over the world have signed the statement of the *UNEP Finance Initiative*, in which they commit to integrate social and environmental criteria in all of their business activities. *UNEP FI* organises all kinds of meetings and work groups to help the signatories bring this objective into practice The organisation has launched a guidance note that should help the financial institutions with developing their policies.

  The OECD is also engaged in a multi-stakeholder initiative "to develop a guidance that will clarify the potential approaches for application of due diligence for responsible business conduct in the financial sector".[259]

  *This leads to assessment element* 7*.*

- **Asset management**

  Through the UNEP Finance Initiative, in April 2006 an international group of asset management companies, investment funds and pension funds launched the Principles for Responsible Investment (PRI). The signatories promise to from now on "integrate environmental, social and governance issues in their investment decisions". The PRI makes various suggestions on how to take these topics into consideration, such as purchasing sustainability analysis and developing active voting and engagement policies. By March 2016, the PRI has been signed by 1,493 institutional investors (pension funds, insurance companies and asset management companies).[260] Many of the signatories are subsidiaries and sister companies of large international banks.[261]

  *This leads to assessment element* 8*.*

- **Money laundering and terrorist financing**

  The international standard in the field of money laundering is set by the Financial Action Task Force (FATF), a work group that was established by the OECD in 1989. The FATF comprises of 36 members, mostly governments of OECD-member states. The FATF aims to promote the successful implementation of legal, regulatory and operational procedures for combating money laundering, the financing of terrorists and other associated threats to the integrity of the international financial system.

  The FATF has developed a set of 40 recommendations that are considered as the international standards for the combating of money laundering. These recommendations offer guidelines and tools to governments and financial institutions to fight money laundering and criminal earnings at all levels. The recommendations have been published in 1990, but have been revised in 1996, 2001, 2003 and 2012. The FATF has also published several Interpretative Notes, which provide guidance on the application of the guidelines in practice.

  The *Forty Recommendations* have been taken over by numerous international institutions, such as the World Bank and the International Monetary Fund (IMF), as well as by the governments of many countries. In February 2013, the European Union processed the latest edition of the Forty Recommendations in the Fourth European Money Laundering Directive.

The Wolfsberg Group, a group of 11 international banks that undertake a lot of activities in the field of *private banking* (banking for rich private clients), published a revised edition of the Wolfsberg Anti-Money Laundering Principles on Private Banking in May 2012. In these principles, the FATF-recommendations are further elaborated on asset management and private banking. In addition, the Wolfsberg Group has also published various other principles in the field of money laundering, financing of terrorism and corruption.

*This leads to assessment elements 9 and 10.*

- **Project financing**

In June 2003, a group of leading banks on the project financing market launched the Equator Principles, together with World Bank subsidiary International Finance Corporation. The principles relate to project financing, a specific type of company financing intended for large, complicated projects. This is one of the ways in which mines, oil and gas plants, chemical factories, roads, railways, dams and other types of infrastructure are being financed. The Equator Principles have been signed by 83 financial institutions. Jointly, these financial institutions represent a major part of the global project financing market.

The Equator Principles are intended to recognise, assess and control the social and environmental risks of project financing. For this purpose, the risk assessment procedures and the Performance Standards of the International Finance Corporation are followed. This means that all financing requests for projects with a value of USD10 million or more are divided into three categories based on their expected effects. Depending on the category, an environmental impact assessment and an environment management plan are requested. Also, social and environment conditions can be included in financing contracts and regular reporting from clients on these topics is required.[262]

By now the principles are updated for the third time. The Equator Principles 3 have been published in June 2013. The most important changes are:

- The scope has been widened, with transitional loans and project related corporate loans.
- More transparency about the assessment is expected due to obligation to publish reports.
- There should be more attention for *due diligence* regarding human rights and climate change.

*This leads to assessment element 11.*

- **Bond issuances**

The International Capital Market Association (ICMA) in 2014 created the Green Bond Principles (GBP) and lastly updated them in March 2015. The principles are voluntary guidelines that recommend transparency and disclosure, and promote integrity in the development of the fast growing Green Bond market by clarifying the approach for issuance of a Green Bond.

Thereby Green Bonds are defined as projects and activities that will promote progress on environmentally sustainable activities as defined by the issuer (Principle 1) and in line with the issuer's project process for evaluation and selection (Principle 2). The management of Green Bond proceeds should be traceable within the issuing organization (Principle 3) and issuers should report at least annually on use of proceeds (Principle 4). As for the current market situation, four types of Green Bonds can be defined: Green Use of Proceeds Bonds, Green Use of Proceeds Revenue Bonds, Green Project Bonds and Green Securitized Bonds.[263]

*This leads to assessment element 12.*

- **Sustainable banking**

  In January 2003, the civil society organizations network BankTrack launched the Collevecchio Declaration on Financial Institutions and Sustainability. The declaration calls upon financial institutions to accept six obligations that explain the expectations of society regarding the role and responsibilities of financial institutions. It concerns the obligation for sustainability, not causing any harm, responsibility, accountability, transparency and sustainable markets and regulations.[264]

  In November 2006, the Collevechio Declaration was further elaborated in the handbook: The do's and don'ts of Sustainable Banking. This handbook provides a lot of concrete and practical advice to banks that want to make their business activities sustainable: where banks have to start, what they have to pay attention to, which challenges they face and what has to be avoided.

  *This leads to assessment elements 2, 3 and 4.*

### 3.2.3 Assessment elements

To prevent that the monies of a financial institution still end up at companies, governments, and other parties that do not trade according to the principles of the financial institution via detours, it is important to establish rules for financial relations with other commercial banks and multilateral banks. This mainly concerns loans to other banks and investments in shares and bonds of other banks.

The following elements are crucial for a policy regarding the companies a financial institution invests in or finances:

1. Financial institutions report on their tax payments to governments for each country where they operate.
2. Financial institutions do not participate in transactions nor grant advice for safeguarding tax advantages as the main objective.
3. Financial institutions are not active in risky trade and investment activities (trade in options, futures and other derivatives) on their own account, other than covering the financial risks of their credit provision.
4. Financial institutions have drafted investment policies on sensitive industries and crucial issues, based on international treaties and conventions.
5. Financial institutions endorse the UN Global Compact principles.
6. Financial institutions endorse the OECD Guidelines for Multinational Enterprises
7. Financial institutions endorse the UNEP FI declaration.
8. Financial institutions endorse the PRI declaration.
9. Financial institutions comply with the FATF recommendations.
10. Financial institutions comply with the Wolfsberg Principles.
11. For project financing, financial institutions apply the Equator Principles.
12. For bonds issuances, financial institutions apply the Green Bond Principles.
13. Companies publish a sustainability report that may contain (a number of) Standard Disclosures from the GRI G4 Sustainability Reporting Guidelines.
14. Large enterprises and multinational enterprises publish a sustainability report that is set up in accordance with the GRI G4 Sustainability Reporting Guidelines, which includes the Financial Services Sector Disclosure (FSSD).

## 3.3 Fisheries

### 3.3.1 What is at stake?

The capacity of the global fishing fleet is about two and a half times larger than the number of fish the ocean can produce.[265] As a result of this, in 2010 more than half (52%) of waters were fished to the maximum, with another 25% overexploited, depleted, or recovering from depletion. Some important commercial fish stocks, such as that of the North Atlantic Cod, the Patagonian toothfish, swordfish and blue fin tuna, have all collapsed or show signs of strong decline.[266] Research also shows that shortage of krill leads to a decrease in the penguin population.[267] Fisheries can be located in the sea, in freshwater bodies or even on land, including many different forms of fishing and aquaculture. The sector has a wide variety of issues from land tenure, environmental problems, labour risks, water use and water quality, health management, food safety, disease control and genetic engineering.[268]
The following problems lead to the depletion of fish stocks:

- Various fishing techniques - such as drift nets - have a large impact on the survival of fish species and other animals that are captured by accident. Examples of these are turtles, seabirds and marine mammals. Other ways of fishing - such as trawling - destroy the natural sea environment and change the composition of the seabed, a composition that is desperately needed to maintain and restore the biodiversity in our oceans.[269]

- Overfishing deprives local fishing communities of their source of food and income. One percent of the global industrial fishing fleet accounts for 50% of the global fish catch and the communities depending on small-scale fishing are already suffering serious consequences, such as the loss of food sovereignty and security.[270]

- Globally, governments grant between EUR 27 billion and EUR 35 billion of subsidies to the fishing industry.[271] These government subsidies lead to undue investments in the fishing fleet and in this way overfishing is stimulated. In the long term, such subsidy policies also lead to major economic damage for the fishing industry itself. The report Paying for Overfishing stated in July 2013 that due to overfishing EUR 3,2 billion of economic value is lost within the EU annually. The main reason for this is that the reduced fish stock will impact the fishing companies' turnover and leads to job loss in the industry. The Jobs Lost at Sea report states that if fish is caught in a sustainable way in Europe, this would provide 100,000 jobs annually.[272]

- Bycatch occurs where fish (or other animal species) are captured inadvertently during fishing and are afterwards mostly thrown back into the ocean. On average, at least 7.3 million tons of marine life are caught incidentally, in some industries the percentage of bycatch is far more than that of the target catch.[273] Tropical shrimp trawling accounts for up to 62% of all global discarded catch. Of every kilo of shrimp caught, on average 1.65 kg of bycatch is netted and subsequently discarded. However, this number could be much higher, especially where bycatch reduction devices have not been implemented.[274]

- Fishing gear lost or left behind at sea (so-called ghost fishing) can cause unintended catch and is environmentally polluting, with the fish catch getting wasted as well.[275]

- A significant problem for the sustainable management of fisheries is the *illegal, unregulated and unregistered* (IUU) fishing that violates international and national protective measures for fishing. It often concerns boats that use so-called *flags of convenience*: the boats are registered in countries that do not monitor their fishing industry, or do so ineffectively.[276] Many communities that rely on fishing as a source of income and food also suffer from IUU. It is estimated that losses from illegal catch alone cost West-Africa as much as USD 1.3 billion annually. In Senegal IUU loss is estimated at around USD 300 million in 2012, which is equivalent to 2% of the GDP.[277]

Because wild catch has decreased in recent years, the increase in fish production is due to the development of fish farms.[278] Fish farming is often praised because it could be of importance for the diversification of revenues and the diet of poor coastal communities. Yet, fish farming can also have negative effects on, for example, the mangroves and coastal *wetlands*, on the water quality and on the genetic variation of local fish species. The FAO Code of Conduct for Responsible Fisheries asks countries to ensure that the harmful consequences of fish farms on the environment are quantified and minimised.

Also, in the socio-economic field there are often problems involving fish farms, such as social conflicts around land rights, loss of employment and revenue sources and poor working conditions. And because some fish species need a disproportionate amount of proteins to grow (for one kilogram of salmon three kilos of protein is needed, and for each kilo of tuna ten kilograms of protein is needed), fish farms are also advised to switch to vegetarian fish species such as catfish and tilapia.[279]

If the current situation does not improve, the fish stocks of all types that are presently fished for food purposes will be depleted by 2050.[280] But it is not only necessary for the future of sea life that fishing is kept under control. Action against overfishing is also crucial for small scale fishing communities because they are at risk of losing their income and sources of food supply due to industrial overfishing. In order to make the fishing industry sustainable, the following changes are necessary:

- Abrogation of harmful fishing techniques such as drift nets and trawls;
- Fishing more selectively, making use of equipment that prevents the catch of other species - such as other fish, birds and mammals -;
- A strong reduction in the fish quota for many fish species; and
- Respecting the rights of population groups that depend on small-scale fisheries.

Although the latter two changes have to be driven by national and international legislation, the investment policy of financial institutions can offer support to the first two changes. The policy of the financial institution has to ensure that financial institutions only invest in or finance fishing companies that do not use harmful fishing techniques or have untargeted bycatch. Investments in fish processing companies can only take place if it is ensured that no harmful fishing techniques are being used or untargeted bycatch takes place in the supply chain. When developing policies for this industry, financial institutions can make use of the international standards described in the following section.

### 3.3.2 International standards

International conventions and codes of conduct agreed under the supervision of the Food and Agriculture Organisation of the United Nations (FAO), show clear agreement with respect to the management of fish stocks. The UN Convention on the Law of the Sea (UNCLOS), the UN Straddling Stocks Agreement and the FAO Code of Conduct for Responsible Fisheries, contain clear objectives on the sustainable use and management to safeguard international fishing waters. The FAO Code was established in 1995 as a framework for international efforts to encourage fishing activity that is sustainable and in harmony with the environment. It provides principles and standards for the conservation, management and development of fisheries around the world. In July 2009, the World Conservation Union published a report in which the UNCLOS has been evaluated and in which case studies and recommendations for a sustainable fishing policy and its respective implementation are presented.

Within the conventions described above there is broad agreement on the principles and measures necessary to realise sustainable use and management of international fishing waters. These are shown below.

- **Endangered fish species**

  The FAO Code of Conduct for Responsible Fisheries recognises the importance of the protection of endangered fish species. Therefore, trade in a lot of fish species, also of some important commercial species, is presently prohibited or is under the strict supervision of the Convention on International Trade in Endangered Species of Wild Fauna and Flora (CITES).

  *This leads to assessment elements 1 and 2.*

- **Protected areas**

  The critical importance of protected marine areas is acknowledged - the so-called Marine Protected Areas *(MPAs)* - for the maintenance and recovery of the biodiversity of fish and other marine life. In some MPAs, fishing is entirely prohibited (so-called *no-take zones*), in order to allow the ecosystem to restore itself and over time be able to serve as a *reservoir* for the rest of the ocean. These MPAs are part of the IUCN classification, amongst others. However, the IUCN itself has no jurisdiction regarding the implementation of MPAs or no-take zones. (Local) governments, fishery authorities and communities do have this jurisdiction. Furthermore a local government of a fishing community may, independent of the IUCN advice, decide to identify a no-take zone or an MPA for the protection of marine ecosystems, bottom of the sea fauna, breeding areas for fish and fish populations. No-take zones, for example, are a normal method for managing the fish stock (of commercial types of fish) in the fisheries industry.

  *This leads to assessment element* 3.

- **Harmful fishing techniques**

  The FAO Code of Conduct for Responsible Fisheries sets a clear priority for the use of selective and environmentally friendly fishing gear and techniques.[281] The Code proposes to prohibit the use of irresponsible fishing techniques[282] and in addition requires that the effects of new fishing techniques on living environments are assessed before they are marketed. Also, international standards are drafted that restrict or prohibit the use of certain methods and materials, such as the use of explosives and cyanide,[283] the use of drift nets,[284] the use of trawls in deep seas and so-called *shark-finning*, where shark fins are cut off and the sharks are thrown back into the ocean.[285]

*This leads to assessment element 4.*

- **Minimising by catch**

The FAO Code of Conduct for Responsible Fisheries establishes that “waste, non-target species, both fish and non-fish species, and impacts on associated or dependent species are minimized.” Action plans are drafted that reduce the by catch of certain species, mainly seabirds and sharks.

*This leads to assessment element 5.*

- **Banning overfishing and restoring fish stocks**

Under the UN Straddling Stocks Agreement countries are obliged “to prevent or prohibit overfishing”. Countries and other management companies of fisheries have to do their utmost to restore endangered habitats.[286] Decisions on these fisheries have to be based on recent scientific evidence and have to be aimed at maintaining and restoring the fish stocks.[287] Also, governments have agreed with the FAO to take action to, amongst others, “review the capacity of fishing fleets in relation to sustainable yields of fishery resources and where necessary reduce these fleets”.[288]

*This leads to assessment element* 6.

- **Ghost fishing**

The MARPOL 73/78 Agreement (1973) first regulated the problem of ghost fishing by prohibiting lowering or sinking fishing gear into the sea. In 1991, the FAO published a series of recommendations for the so-called Marking of Fishing Gear.[289] In March 2005, the European Commission released the Passive Fishing Gear and Beam Trawls Marking and Identification Regulations, in which fishing boats are obliged to mark passive fishing gear with the registration number of the boat.

*This leads to assessment element 7.*

- **Illegal, unregulated and unreported fishing (IUU)**

The FAO IUU Plan of Action seeks to prohibit these practices by convincing countries not to do business with companies that are guilty of IUU fishing. This includes regulations with regard to sailing under ‘flags of convenience’ (FOCs). FOCs allow for IUU fishing and also present major labour problems. So-called ‘FOC countries’ allow fishing vessels to fly their country’s flag for no charge, without taxation, and do not address any violations of international fisheries laws. FOC fleets are especially active in fishing for commercially valuable species and are also involved in poaching fish in waters of developing coastal countries, which do not have the means to patrol their waters, resulting in negative impacts on local fish stocks, employment and food security.[290] In terms of labour issues, FOC fleets typically have very low wages and very bad labour and safety conditions on board. Furthermore, FOC registries make it much more difficult for unions, industry stakeholders and the public to hold ship owners to account.[291]

A WWF Report on IUU fishing (2005) advises the financial industry to ensure they only finance legal fishing activities. For this purpose, financial institutions would have to require of all investees that the entire production and processing chain is properly documented.[292]

*This leads to assessment elements 8 and 9.*

- **Fishery management based on ecosystems**

While the former international standards on fishing were developed based on the fish stocks of certain species, the current rules are more often based on entire ecosystems. For example, the UN Straddling Stocks Agreement not only requires that the fish stocks of the targeted species are maintained, but also that the fish stocks of other fish species that live in the same ecosystem are monitored and protected.

Also, the FAO Code of Conduct for Responsible Fisheries obliges fishermen to preserve marine ecosystems: so that not only the species being fished, but all fish species that depend on this species or are part of the same ecosystem are protected. This is even further elaborated in FAOs Ecosystem-Based Management (EBM) framework for fisheries, developed by the WWF. With respect to small-scale fishing in poor countries, the FAO Code of Conduct for Responsible Fisheries contains guidelines to protect the food security and the livelihoods of fish dependent communities in the poorest countries of the world.

In order to identify sustainable fisheries and fish farms, financial institutions can make use of the Greenpeace 'Red-Grade' Criteria for Unsustainable Fisheries and the Greenpeace 'Red-Grade' Criteria for Unsustainable Aquaculture. In these fact sheets, a number of questions are included with which one can easily establish whether a given company in the fishing industry is sustainable. The indicators are based on the FAO Code of Conduct for Responsible Fisheries.

*This leads to assessment element 10.*

- **Certification of sustainable fish and fishing**

The leading organisation on certifying the sustainable catching of fish is the Marine Stewardship Council (MSC). The MSC certification standards are based on the FAO Code of Conduct for Responsible Fisheries and are the only global standards that are consistent with the FAO Guidelines for the Ecolabelling of Fish and Fishery Products from Marine Capture Fisheries.
The MSC Principles & Criteria were established in 1999 in an international multi-stakeholder process. So far, the MSC has certified 275 fisheries, while almost 103 fisheries are presently being investigated for certification. Combined, the MSC certified fisheries bring in almost 8.8 million tonnes of fish, more than 10% of the fish that is captured globally.[293] Naturally, as MSC does not provide certification for all types of fisheries, MSC certification for those fisheries cannot be required. Besides standards to certify fisheries, the MSC has also developed a traceability system, the MSC Chain of Custody Standard, by which the origin of certified fish products can be traced throughout the entire production chain.

In the Netherlands, the North Sea Fish Centre has established a standard for North Sea fish. Initially, a Guarantee of Quality Trademark has been developed for plaice. Sustainable fishing is part of the Quality Trademark because fishermen need to register for a full assessment from the MSC. Furthermore, emphasis is placed on a guaranteed origin (the North Sea). A group of plaice fishermen working closely with the company Queens markets the plaice under the MSC certification. Abroad, plaice is marketed as 'North Sea Plaice'.[294]

Also, the Group of Wadden Islands has drafted guidelines for a number of fish species that can be sold under the Waddengoud certificate, provided it is captured and processed in the Wadden region: shrimp, mullet, sea bass, cockles, mussels, pike-perch, Japanese oysters, sole and smelt. It also includes guidelines for sustainable fishing.[295]

*This leads to assessment elements 11, 12 and 13.*

- **Sustainable aquaculture**

  In August 2006, the International Principles for Responsible Shrimp Farming were launched. After a process of five years, in which various organisations - such as the Network for Aquaculture Centres for the Asia-Pacific, the WWF, the World Bank and the United Nations Environmental Programme (UNEP) - were involved, an international framework was established that seeks to guarantee sustainability within the shrimp industry.[296]

  The Global Aquaculture Alliance (GAA), which is an initiative by American companies, has developed a system of certification with regard to fish farms. Today there are standards for shrimp, tilapia and Channel catfish cultivation, as well as for the fish processing industries. In this system animal welfare criteria have been incorporated, applying mainly to pain and anxiety, as scientific research has shown that fish may experience such sensations as well.

  GAA has developed the Best Aquaculture Practices (BAP) facility certification standards, monitored and controlled by ISO 65-accredited certification bodies. BAP certification defines the most important elements of responsible aquaculture and provides quantitative guidelines by which to evaluate adherence to those practices for processing plants, farms, hatcheries and feed mills. The number of BAP-certified facilities worldwide grows daily. BAP is mainly active in the Americas, South East Asia, Australia and New Zealand; within Europe only in Iceland, Norway and the United Kingdom.

  In 2010, WWF and IDH (Dutch Sustainable Trade Initiative) founded the Aquaculture Stewardship Council (ASC). The ASC has as its goal to be the world's leading certification and labelling programme for responsibly farmed seafood, by managing the global standards for responsible aquaculture, which were developed by the WWF Aquaculture Dialogues.

  ASC collaborates with aquaculture producers, seafood processors, retail and foodservice companies, scientists, conservation groups and consumers in order to: [297]

  - “Recognise and reward responsible aquaculture through the ASC aquaculture certification programme and seafood label;
  - Promote best environmental and social choice when buying seafood; and
  - Contribute to transforming seafood markets towards sustainability.”

  *This leads to assessment elements 14 and 15.*

- **Sustainability reporting**

  The Global Reporting Initiative has drafted guidelines on how to write sustainability reports. Besides the general G4 Sustainability Reporting Guidelines it also provides sector guidance for a number of industrial sectors. In the Food Processing Sector Supplement (FSSS), guidelines are also included with respect to animal welfare, fair trade, health and wellbeing of consumers, impact on natural resources and packaging, have been included. The guideline was especially developed for companies that are involved in the processing of food and beverages. For small and medium enterprises (SMEs), less elaborate sustainability reporting is required. SMEs can report on the GRI indicators that are relevant to their operations, for example by following the High5! Approach.

  *This leads to assessment element 16 and 17.*

- **Procurement and supply chains**

  Companies are often part of long production chains. They can monitor one another and question how they respect local and national legislation and international norms regarding social, economic and environmental issues. The requirements that companies set for their suppliers can be included in contractual agreements. The importance of this is also recognised in the OECD Guidelines for Multinational Enterprises since its revision in 2011.

  Also the ISO 26000 guideline recognises the importance of supply chain responsibility, because "the impacts of an organization's decisions or activities can be greatly affected by its relationships with other organizations." A companies' sphere of influence includes relationships within and beyond an organization's supply chain.[298]

  The United Nations Guiding Principles on Business and Human Rights include a due diligence process in order to identify, prevent, mitigate and account for how companies address their adverse human rights impacts. The process "should cover adverse human rights impacts that the business enterprise may cause or contribute to through its own activities, or which may be directly linked to its operations, products or services by its business relationships."[299]

  *This leads to assessment elements 18 and 19.*

### 3.3.3 Assessment elements

Financial institutions that invest in or finance the fishing industry should ensure that their investments contribute to the internationally accepted objectives for the sustainable management of fisheries. It is important that the investment policy of financial institutions include the entire production chain of fish and shellfish. Sustainable investments in this industry are important on all levels of the chain, from the catch to the processing and the sale.

The following elements are crucial for a policy regarding the companies a financial institution invests in or finances:

1. Trade in endangered animal species complies with the CITES conditions.
2. Trade in endangered animal species that are on CITES lists, is unacceptable.
3. Fishers respect *Marine Protected Areas* and especially *no-take zones*.
4. Harmful fishing techniques (such as trawls, drift nets and *shark-finning*) are unacceptable.
5. Fishers minimise their by catch.
6. Fishers prevent overfishing.
7. Fishers do not engage in ghost fishing or they comply with MARPOL or EU regulations.
8. Fishers do not operate under *flags of convenience*.
9. Fishers carefully document their catch so the origin of the total catch can be checked.
10. Fishers comply with all elements of the FAO Code of Conduct for Responsible Fisheries.
11. Fishers are certified according to the Marine Stewardship Council (MSC) criteria or comparable standards for at least one fishery in which they operate.
12. Fishers are certified according to the Marine Stewardship Council (MSC) criteria or comparable standards for all fisheries in which they operate.
13. Fish traders and other companies in the production chains for fish and shellfish are certified according to the MSC Chain of Custody standard.
14. Shrimp farms comply with the International Principles for Responsible Shrimp Farming.
15. Fish farms are certified according to the Aquaculture Stewardship Council (ASC) criteria.
16. Companies publish a sustainability report that may contain (a number of) the Standard Disclosures from the GRI G4 Sustainability Reporting Guidelines.

17. Large enterprises and multinational enterprises publish a sustainability report that is set up in accordance with the GRI G4 Sustainability Reporting Guidelines, which includes the Food Processing Sector Disclosure (FSSD).
18. Companies integrate social, economic and environmental criteria in their procurement and operational policies.[xv]
19. Companies include clauses on the compliance with social, economic and environmental criteria in their contracts with subcontractors and suppliers.

## 3.4 Food

### 3.4.1 What is at stake?

Food production is a key factor in achieving the second of the Sustainable Development Goals: to end hunger, achieve food security and improved nutrition and promote sustainable agriculture.[300] The right to food (Article 25 of the Universal Declaration on Human Rights) is the most basic human right, and the food sector has a major role to play so that it can be respected, protected and fulfilled everywhere, always.

The Voluntary Guidelines to Support the Progressive Realization of the Right to Adequate Food in the Context of National Food Security adopted by FAO Council in 2004 reflects the consensus among FAO member countries on what needs to be done in all of the most relevant policy areas to promote food security. In this reference document the right to food is considered as the situation "when all people, at all times, have physical and economic access to sufficient, safe and nutritious food to meet their dietary needs and food preferences for an active and healthy life."[301] It does not only address the final outcome of food security for all, it also proposes ways and tools by which that goal is reached and achievements maintained in a sustainable manner. Food security has long been regarded as a matter of balancing supply with demand. In the past, policies were limited to increasing agricultural production and/or slowing population growth. Nowadays food security is based on the four pillars: availability, access, utilization and stability.[302]

The food sector's first objective should be to ensure food security for all human being and all communities in the world. The sector consists of agricultural companies, including small-scale family producers, food processing companies and retail companies. This diverse group of companies forms the food supply chain. The food processing sector "[i]ncludes all companies that are engaged in processing food, as well as food commodity trading related to food processing and fish processing, and beverage companies. [T]he food processing industry includes a diverse group of companies involved in the processing of products like fish, meat, milk, crops and water. It includes millions of Small & Medium Enterprises (SMEs) worldwide and also some of the largest companies in the world. Many of these companies deliver products directly to consumers, while others specialise in Business-to-Business activities (ingredients, commodity markets). Some companies directly participate in all areas of food production, from farming activities through to final production and retail. Others are concentrated more at the top end of the production chain or buy through commodity markets".[303]

xv If the financial institution has no specific sector policies or does not mention this in its sector policies, but does mention this in cross-cutting policies for at least three themes, the financial institution is deemed to comply with this element.

Nowadays, companies operating in food supply chains are facing major sustainability issues. The demand for agricultural products is growing more rapidly than the world population. One of the reasons for this is that consumption patterns in emerging markets (such as the BRICS-countries: Brazil, Russia, India, China and South Africa) are increasingly starting to resemble those in industrialised countries with an increase in meat and dairy consumption globally. In order to feed the expanding global livestock needed for this pattern, large amounts of raw materials containing protein are needed. Another cause of the growing demand for agricultural raw materials is the development of biofuel production. Biofuel is produced using palm oil, corn and sugar cane as well as other food and feed crops.[304]

The sharp increase in the global demand for agricultural products leads to economic, social and environmentally related problems:

- Globally, the agriculture industry is the largest contributor to soil depletion, environmental pollution and the degradation of ecosystems. To meet the growing demand for agricultural products, a lot of natural ecosystems and living environments have to make way for agricultural activities.[305]

- Globally the agricultural industry is the largest user of freshwater resources, using up to 90% of available freshwater in developing countries. Following predictions of population growth and the subsequent increased demand for food, water demand is also expected to increase while availability is decreasing.[306] Producing animal-based food accounts for 46% of global freshwater withdrawals.[307] By 2050, the agricultural sector will have to produce 60% more food globally and 100% more in developing countries. Substantial changes in policy and management, throughout the entire agricultural production chain, are required to ensure that the available water resources are used in the best way possible, to meet growing demands for food and other agricultural products.[308]

- Due to the $NO_2$- and $CH_4$ emissions, the global agriculture industry is responsible for 10-12% of the global emissions of greenhouse gases due to the use of fertilisers and the methane emissions from rice fields and cattle.[309] According to a study by Delft Hydraulics, drainage of bogs and deforestation by the agriculture industry also substantially contributes to the global $CO_2$-emission. Especially in the production of palm oil, peat land is frequently drained and burned to make room for plantations, leading to substantial greenhouse gas emissions and serious health risks for local and regional populations.[310]

- The agriculture industry strongly contributes to harmful emissions to the environment, with the role of livestock being particularly significant. According to the Intergovernmental Panel on Climate Change (IPCC), agriculture and deforestation (largely driven by expansion of agricultural land) are responsible for around 25 percent of global emissions.[311] This is mainly due to the production and processing of cattle feed (45% of the total amount) and the gases produced by cattle as they digest their food (39%). The FAO has calculated that a 30% reduction of greenhouse gas emissions is possible if the producers switch to so-called best practices.[312] Notably, the world's ten largest food companies emit 263.7 million tons GHGs per annum. Implementing best practices at these companies would have major effects.[313]

- The livestock industry is also responsible for 53% of human ammonia emissions that cause acid rain and acidification of ecosystems. Moreover, the livestock industry uses 70% of all agriculture land available and 8% of the global water consumption. Global figures are not available, but the contribution of the livestock industry to water pollution through antibiotics, hormones, sediments, fertilisers, pesticides and other chemicals is very high. Research has shown that some meat and poultry producers are responsible for a higher rate of water pollution than large companies in the fossil fuel industry.[314]

- In intensive livestock farming the welfare of animals such as laying hens, calves and pigs can be threatened, both within production companies as well as during transport to slaughterhouses. Intensive large-scale husbandry also increases risks of spreading diseases.[315]

- An unintended by-product of agricultural practices in which fire is used (such as unprofessional palm oil production plants), together with (fire-led) deforestation and the draining of peatlands are peatland fires.[316] Peatland fires contribute to an estimated 13-40% of the mean annual global carbon emissions from fossil fuels, and contributed greatly to the largest annual increase in atmospheric $CO_2$ concentration detected since records began in 1957.[317]Furthermore, peatland fires can cause serious health problems and widespread destruction, as was the case in 2015 in Indonesia.[318]

- In assessing the sustainability impacts of e.g. soy expansion and biofuel crops in general, it is important to consider Indirect Land Use Change (ILUC). Biofuel production typically takes place on cropland which was previously used for other agriculture such as growing food or feed. Since this agricultural production is still necessary, it may be partly displaced to previously non-cropland such as grasslands and forests. This process is known as indirect land use change (ILUC). While they may not deforest themselves, it is clear that the demand for cash crops does indirectly push these type of companies further into the frontier, leading to ILUC. Especially in the debate on biofuels, ILUC plays a crucial role: when ILUC is taken into account, there is no positive climate impact from first-generation biofuels. Especially those pushing the rangeland frontier into the Amazonian forests, could offset the carbon savings from biofuels.[319]

- In regards to genetically modified organisms (GMOs), there are several concerns about potential unintended health and environmental impacts. Examples include negative impacts on beneficial insects, weed tolerance, new allergens and toxins. Furthermore, concerns also exist about the spreading of harmful traits to weeds and non-GM crops.[320] While there is an active debate about the safety of GMOs, it is the position of Fair Finance Guide International that at this time GMOs should be avoided, as risks of contamination of other cultivated or wild varieties, as well as side-effects from the crossing of genes from entities that do not belong to the same natural category, cannot be excluded given the current state of scientific knowledge.

- A combination of factors (the varroa destructor, changed habitat, loss of biodiversity, use of pesticides) form a serious threat to the honeybee. In the last few years, the number of bee colonies has decreased by 20 to 30% and a further decrease could lead to a shortage in pollination with large consequences for agriculture harvest. About ninety agricultural products, accounting for a third of the global food production, depend on animal pollination. Honeybees are the main animal pollinator and are responsible for 80 to 90% of this pollination.[321] Research shows that some insecticides can cause a decrease in the production of the number of queen bees and other insecticides negatively influence the number of bees that find their way to their beehive.[322]

- In some countries the expansion of agricultural activities is associated with the expropriation of land inhabited by local communities or indigenous peoples. As a result, these people are not only deprived of their property and the right to use their land, but also of their familiar habitat, cultural riches and sources of food and income. Reports from the GRAIN, International Land Coalition and the World Bank show that the number of transactions in which land is purchased for the expansion of agriculture activities increased tenfold in 2009 compared to the previous years.[323]

- A lot of agricultural companies do not comply with internationally recognised labour rights. There are countless examples of forced labour, child labour, low wages and insufficient protection of the health and safety of employees.[324]

- The development of infrastructure such as roads, railways and waterways goes hand in hand with the development of an export-oriented agriculture industry and can have very negative effects on ecosystems and local societies. The construction of roads in forest areas facilitates, for example, access for poachers and illegal loggers. The construction of infrastructure can also lead to land rights conflicts and rising land prices for the original inhabitants.[325]

- The macro economic effects of the agriculture and livestock industry are often detrimental for developing countries due to the often unfavourable terms of trade for these countries, the agriculture subsidies in richer countries and the dumping of subsidised agricultural products in developing countries. This leads to an unfair balance of power in the entire production, distribution and consumption chain. Due to a strong increase in food prices in recent years, more and more people in developing countries are living below the poverty line.[326]

  FAO calculated that an eighth of the global population (842 million people) in the years 2011-2013 suffered from persistent food shortage. While this total is 17% less than in the period 1990-1992, progress still needs to be made. Large differences across regions persist. For example, Sub-Saharan Africa remains the region with the highest prevalence of undernourishment, with modest progress in recent years. Western Asia has shown no progress, while Southern Asia and Northern Africa show slow progress. Significant reductions in both the estimated number and prevalence of undernourishment have occurred in most countries of Eastern and South Eastern Asia, and also in Latin America.[327]

To offer a sufficient and nutritious diet to global citizens and to enable socio-economic development of poorer countries, unfavourable terms of trade in agricultural products for developing countries have to be addressed and disturbing subsidies and dump practices have to be prohibited. In addition, the use of agricultural fields for the production of biofuels and animal feed has to be discouraged, as it displaces food production for the local population and poses a threat to their right to food security.

Also, the debate around the phenomenon of *land grabbing* has grown stronger. Land grabbing occurs when foreign companies, countries, or investors buy or rent land for large-scale industrial and/or commercial agriculture production oriented on the export market at the expense of land rights of the local communities concerned. Mainly in developing countries, the lack of consultation and transparency for the allocation of land is a problem. Evictions and conflicts over land are often paired with a violation of basic principles, such as an impact assessment, compensation and rehabilitation. Besides these direct consequences, there is the problem of the reduced availability of land for local actors. The national market will be aimed more at producing crops for the food and the biofuel industry on the global market and less on sustainable peasant agriculture, for the local and national market for current and future generations.[328]

The above mentioned developments lead to a global food crisis with catastrophic consequences for many people. People in developing countries spend about 50 to 80% of their income on food. They can only respond to an increase in food prices by reducing their food consumption and suffering from hunger. Those that are already living on the edge are the most vulnerable, such as the landless, slum dwellers and itinerant labourers. Furthermore, women and children primarily belong to risk groups.[329]

Feeding more than seven billion of the world's habitants in a sustainable way is one of the major challenges the world is facing. All parts of the chains within the food industry - from farmers, middlemen, transporters and processing companies to supermarkets - will have to make an effort in this. Also, financial institutions that invest in or finance companies at all stages of food chains will have to develop policies that take all above mentioned problems into account. When developing an investment policy for this, industry banks can make use of the international standards described in the following section.

### 3.4.2 International standards

In recent years, various initiatives have been set up to develop standards for both the agricultural industry as well as the food industry. Some initiatives focus on general, industry-wide agreements, while others focus on specific crops. A short overview of the main standards is depicted below.

- **Right to adequate food**

  According to Article 25 of the Universal Declaration of Human Rights "everyone has the right to a standard of living adequate for the health and well-being of himself and of his family, including food, clothing, housing and medical care and necessary social services, and the right to security in the event of unemployment, sickness, disability, widowhood, old age or other lack of livelihood in circumstances beyond his control."

  These rights have also been protected by The International Covenant on Economic, Social and Cultural Rights. Article 11 of this Covenant guarantees the right to an adequate standard of living including adequate food, clothing, housing and continuous improvement of living conditions.

  In its introduction to the core principles on Large-scale land acquisitions and leases, the Special Rapporteur on the Right to Food has said that achieving the right to food could be pursued much more effectively if host States and investors together agree on a certain amount of conditions, according to which investments will be made.[330] The following guidelines further show how non-State actors could work this issue.

  The FAO Voluntary Guidelines to Support the Progressive Realization of the Right to Adequate Food in the Context of National Food Security, further specifies the right to adequate food and links it to the concept of food security. While the Voluntary Guidelines are written for states, it presents a valuable overview of all the factors determining the realization of the right to food and can therefore be valuable for non-state actors as well.

  The right to adequate food can be supported by companies by improving the nutritional value of food. Obesity, malnutrition and chronic diseases related to dietary patterns are influencing the health of one third of the world's population. This also leads to high health care costs. Malnutrition and obesity are related to the quantity and quality of food. The role of food producers on the food patterns of consumers is large.[331] The Access to Nutrition Index (ATNI) is a benchmark of the world's largest food companies. It encourages companies to provide consumers access to affordable food and beverages with high nutritional value. The ATNI also encourages companies to "responsibly exercise their influence on consumers' choice and behaviour by improving marketing, labelling and the use of claims that promote healthy diets and active lifestyles".[332]

The right to adequate food can also be supported by companies by improving smallholders' access to seeds. The Access to Seeds Index, launched in 2016, is a useful tool for investors. It benchmarks the policies and activities of companies in the seed industry, with regard to making seeds available to smallholder farms in developing countries. Smallholder farms are crucial in fulfilling the increasing demand for food in developing countries. "Currently only 2,5% of the seed used by smallholders in sub-Saharan Africa now comes from seed companies".[333] The Index tries to encourage seed companies to provide smallholders access to high quality seed, as "to increase yields, improve nutritional quality and cope with climate change".[334]

*This leads to assessment element 1.*

- **Labour rights**

The circumstances for health and safety in the agriculture and food industry are often below standard due to the use of huge amounts of pesticides that are used. Wages are generally low and negotiating rights are often not respected. It is therefore of great importance that agriculture and food companies adhere to the main codes of conduct of the United Nations International Labour organisation: the ILO. These are the 1998 ILO Declaration on Fundamental Principles and Rights at Work and the Tripartite Declaration of Principles Concerning Multinational Enterprises and Social Policy.

*This leads to assessment element 2.*

- **Land rights, conflicts and forced evictions**

The right to food, water, housing and work are included in the International Covenant on Economic, Social and Cultural Rights (ICESCR)**.**[335] These rights are connected to the non-defined right to land.

Regarding adequate housing, governments have the obligation to guarantee security of tenure, which includes protection against forced eviction.[336] As noted by the UN Special Rapporteur on Adequate Housing: "Involuntary resettlement amounts to a forced eviction when it occurs without the provision of, and access to, appropriate forms of legal or other protection."[337] The protection measures that should be applied to all evictions are articulated in the Basic Principles and Guidelines on Development-based Evictions (2007), developed by the UN Special Rapporteur on Adequate Housing.[338] They reflect existing standards and jurisprudence on this issue, including detailed guidance on steps that should be taken prior to, during and following evictions in order to ensure compliance with relevant principles of international human rights law.

The 11 core principles of the United Nations Special Rapporteur on the right to food, include the notion that any shifts in land use can only take place with the free, prior and informed consent of the local communities concerned. This is particularly important for indigenous communities, in view of the discrimination and marginalization they have been historically subjected to.

In May 2011, the Tirana Declaration was adopted by over 150 representatives of civil society organisations, social movements, grassroots organizations, international agencies, and governments. According to The Declaration land acquisitions or concessions should, amongst others, be based on free, prior and informed consent of the affected land-users.

*This leads to assessment elements 3 and 4.*

- **Areas of high biodiversity and protected areas**

  Agricultural activities in those areas listed in the categories I-IV of the World Conservation Union, in the UNESCO World Heritage Convention and the Ramsar Convention on Wetlands have to be excluded from investment.

  These areas are also included in the analyses for investments by International Finance Corporation's (IFC) Performance Standard 6 concerning Biodiversity Conservation and Sustainable Management of Living Natural Resources. It determines how companies should operate in order to avoid negative consequences on areas of high biodiversity value, including impact on natural habitats as well as endangered and endemic species. The requirements in the standard have been guided by the Convention on Biological Diversity.

  The *High Conservation Value* (HCV) concept was initially conceived within the framework of certification of forest management and wood products (High Conservation Value Forests or HCVF), but can be applied to all ecosystems and natural living environments. The HCV Resource Network has developed national implementation guidelines, local projects, training, and workshops.

  *This leads to assessment elements 5, 6 and 7.*

- **Protection of genetic material**

  The Cartagena Protocol to the Convention on Biological Diversity has drafted provisions with respect to the use of GMOs and the identification of GMOs in the processing chain. For example, trade in living modified organisms is prohibited unless approval of the importing country has been obtained. Also, signatories of the protocol themselves have to comply with precautionary measures for the production and the use of GMOs. Because the technology and the knowledge of GMOs is still developing, the GMO standards in the Cartagena Protocol are also constantly developing.

  The Bonn Guidelines are recognized as a useful first step in the implementation of relevant provisions of the UN Convention on Biological Diversity (CBD) and are meant to assist stakeholders in developing access to genetic resources and benefit-sharing strategies.

  According to Fair Finance Guide International, companies should at least comply with the relevant guidelines, but preferably refrain from involvement in living genetically modified organisms.

  *This leads to assessment elements 8, 9 and 10.*

- **Animal welfare**

  The European Convention for the Protection of Animals kept for Farming Purposes (adopted in 1976 and amended in 1992 by the Council of Europe) establishes minimum guidelines for livestock. The European Convention for the Protection of Animals during International Transport (adopted in 1968 and amended in 2003 by the Council of Europe) sets guidelines for the transport of animals.

  On a global level there is a Terrestrial Animal Health Code (TAHC) which is conducted by the World Organisation for Animal Health (OIE). This organisation is recognized by the World Trade Organization (WTO) and it has set up guidelines in the TAHC about e.g. cattle transport over land and over sea, how to treat animal diseases and the influence cattle have on public health.[339]

The Dutch Parliament and the European Parliament both have addressed the issue of setting time limits to cattle transport, especially the transport of cattle for slaughter.[340]

The International Finance Corporation (IFC) states in its 2014 Good Practice Note that businesses that address or enhance animal welfare are likely to win or retain a competitive advantage in the global marketplace.

*This leads to assessment elements 11, 12 and 13.*

- **Emissions reduction**

The agriculture industry strongly contributes to harmful emissions, in particular through $NO_2$- and $CH_4$ emissions. The role of livestock is of great significance, but also the methane emissions from rice fields and peat land are important greenhouse gasses. The use of fertilisers and pesticides result in pollution of soil and water.

Globally, the standards of the Greenhouse Gas Protocol (GHG Protocol) are the most used standards to measure and manage greenhouse gas emissions. Amongst others the GHG Protocol has developed a standard for the emissions of products and the corporate value chain. The GHG Protocol is consistent with the IPCC guidelines for reporting $CO_2$-emissions.

*This leads to assessment element 14*, *15* and 18*.*

- **Pesticides**

With respect to the use of pesticides, the FAO has drafted the International Code of Conduct on the Distribution and Use of Pesticides. This code of conduct includes voluntary, internationally accepted norms for the treatment, storage, use and the disposal of pesticides.

*This leads to assessment element 16.*

- **Water use**

Given the immense amounts of freshwater being used to produce food globally, amidst growing shortages, it is vital that this is done as efficiently as possible. It is vital that companies and financial institutions become aware of their own influences on water related problems. Various initiatives, guidelines and standards have emerged in recent years, to help companies address water risk.

Initiatives companies could participate in and learn from are:

- The UN Global Compact's CEO Water Mandate is a public-private initiative designed to assist companies in the development, implementation and disclosure of water sustainability policies and practices.
- The guidance by the UNEP and CEO Water Mandate on Corporate Water Accounting: An Analysis of Methods and Tools for Measuring Water Use and Its Impacts.
- The European Water Partnership; and
- The Water Footprint Network, which also has a standard on assessing a global water footprint.

There are several guidelines and water 'footprinting' methods as well as voluntary disclosure initiatives for calculating water use, water risk, understanding water issues and creating a sound water strategy, such as:

- The CDP's Water Program, to calculate and publish corporate water use throughout the supply chain;
- The GEMI Water Sustainability Tool; and
- The WBCSD Global Water Tool.

Alternately, the AWS International Water Stewardship Standard is a new standard, soon to be supported by a verification process. It defines a set of water stewardship criteria and indicators for how water should be stewarded at a site and catchment level in an environmentally, socially, and economically beneficial manner.

*This leads to assessment elements 18, 19, 20, and 21.*

- **Certification and eco-labels**

The demand for sustainable agricultural products is growing, but on the definition of *sustainable* no general agreement has been achieved as yet. However, *eco-labelling* is taking place on a large scale: granting voluntary and binding sustainability labels to agricultural products. A lot of labels are issue specific (for example *organic* or *fair trade or GMO-free*) and therefore make use of different standards. As a result, the market for sustainable agricultural products is somewhat opaque.

In February 2008, the Sustainable Agriculture Network (SAN) published the Sustainable Agriculture Standards. The norms are based on the United Nations guidelines, the European Union and the International Labour organisation and are endorsed by the Rainforest Alliance. The standards contain fourteen criteria for sustainable agriculture (on waste management, working conditions, health and safety, the use of chemical and biological additives and genetically manipulated seeds). For certification purposes SAN has developed the Farm Certification and Chain-of-Custody certification. Both are used in the certification process of sustainable agricultural companies. The SAN also works on an additional sustainable standard for keeping cattle, in which specific topics are dealt with and previous SAN standards for water and waste management are applied to livestock farms.

With respect to organic farming, the International Federation of Organic Agricultural Movements (IFOAM) has developed the Norms for Organic Production and Processing. These comprise of the IFOAM Basic Standards for Organic Production and Processing and corresponding Accreditation Criteria. All producers worldwide that adhere to the IFOAM norms are included in the Organic Guarantee System.

With respect to fair trade, the Fair trade Labelling Organizations International (FLO) is industry leading. FLO is a cooperation of twenty certification initiatives that *market* the Fair trade label in their own country. Goods that carry the Fair trade label meet the Fair trade Production and Trade Standards, which include both general norms (on investments in local economies and reducing waste) as well as product specific norms (minimum prices and quality standards).

The Responsible Commodities Initiative (RCI), set up by the *Sustainable Food Laboratory* with the support of the UNCTAD and the IISD, is a multi-stakeholder initiative with the aim of stimulating the sustainable production of agricultural products. The RCI has developed a measuring instrument, the Benchmarking tool, which enables measuring improvements in important environmental and social indicators of agricultural production chains. In addition, the benchmark tool assists when developing sustainability norms per crop.

Through The 2050 criteria, WWF provides an overview of the investments criteria for several agricultural resources. By referring to the best practices in the different sectors WWF provides guidance in the search for certification schemes and trends and developments in the environmental and social field.

*This leads to assessment element 21.*

- **Norms for specific raw materials**

  Recently guidelines have been developed for sustainable production and trade for a number of important agricultural products. These guidelines, with the objective to reduce social and environmental problems, are preferably drafted by so-called multi-stakeholder initiatives and roundtables, in which researchers, companies from industries involved, financial institutions, social organisations, and other stakeholders participate. In recent years, the roundtables have defined more and clear standards for the sustainable production of specific crops. Until now multi-stakeholder initiatives for some agricultural products are still lacking, but norms are being drafted by the industry itself. Until these norms have been developed further in consultation with all stakeholders, they are not to be considered as real sustainability norms; but they do offer some guidance in the assessment of companies that produce these agricultural products.

  The main examples of norms for specific agriculture crops are:

  - ***Soy***: If not managed adequately, large scale soy farming causes huge social and environmental damage in Latin America. Clear norms and guidelines are described in the Basel Criteria for Responsible Soy Production, developed by the WWF and Coop Switzerland. Companies will find this non-genetically modified soy expensive, because it needs to be farmed and traded separately, as long as the largest part of the market does not comply with these requirements. The Basel Criteria are also followed in the globally used ProTerra standard.

    The Roundtable on Responsible Soy Association (RTRS), established by organisations and companies in the soy industry, aims to stimulate 'more responsible' production of soy but has less strict requirements. The RTRS Standard that came into force in June 2010 (and was updated in 2013) recognises the environmental and social problems in the soy chain.

    Other standards are the Sustainable Agriculture Network Standard, Fairtrade Production and Trade Standards, standards for organic farming, EcoSocial certification and the Social Responsibility Criteria for Companies that Purchase Soy and Soy Products - developed by the Brazilian Soy Platform. That latter document also places a clear responsibility on financial institutions and other lenders that are involved in financing soy producers. Civil society organizations (CSOs) united in the Dutch Soy Coalition believe that sustainable soy production cannot be achieved without a significant reduction in meat and dairy consumption in Europe, as well as using European farmed crops as cattle feed instead of imported soy.

  - ***Palm oil:*** In October 2007, the Roundtable on Sustainable Palm Oil (RSPO) - a multi-stakeholder initiative with more than one hundred members that represent more than one third of the global palm oil trade - adopted the Principles and Criteria for Sustainable Palm Oil Production (P&C). The P&C is comprised of clear norms on environmental aspects (use of soil, water, chemicals) and social environment (land rights, working conditions, etc.). The norms are based on United Nations, the FAO and the ILO guidelines. In 2016, RSPO introduced additional criteria under the name RSPO NEXT.

In 2013, the Palm Oil Innovators Group (POIG) was established. Within POIG a couple of CSOs (amongst whom WWF and Greenpeace) worked together with palm oil companies in order to improve the RSPO standards.

A 2015 publication of an alliance of international human rights and environmental organisations urges companies to ensure the rights of palm oil workers. The Free and Fair Labor in Palm Oil Production: Principles and Implementation Guidance is not intended as a new code of conduct but as a resource that provides companies with detailed implementation guidance. The publication expects companies to adhere to the following seven principles throughout their supply chain:

- The International Labor Organization (ILO) Core Conventions are upheld;
- Ethical hiring and responsible employment are practiced;
- Reasonable production targets, working hours, and leave entitlements are established;
- A living wage is paid;
- Worker health and safety and the welfare of workers and their families are prioritized;
- Access to remedy is guaranteed; and
- Commit to meaningful due diligence, transparency, and disclosure of human rights policies, procedures, and data, with a focus on labour and employment.

- ***Sugar cane:*** Beside its use in the food industry, sugar cane is increasingly being used as a raw material for biofuel ethanol. Besides huge areas of agricultural land, the sugar industry also uses large quantities of water. The multi-stakeholder Bonsucro unites a number of very large companies and other stakeholders in the industry. The objective of the BSI is to develop international guidelines for sustainable production of sugar cane that can be used by companies and investors worldwide, as well as a certification system. In November 2009, Bonsucro's predecessor, BSI, published a second edition of the BSI Standard, which had been adapted. The standard is comprised of social, environmental and economic norms, focusing on labour rights, the production process and the environment. The Fairtrade Labelling Organizations (FLO) also has a Product Standard for sugar.

- ***Biofuels:*** Palm oil, soy and sugar cane are increasingly often being used as a raw material for biofuels. The Roundtable on Sustainable Biofuels (RSB) is a multi-stakeholder initiative in which companies, scientists and social organisations cooperate. In November 2010, the RSB published the Global Principles and Criteria for Sustainable Biofuels Production, which is comprised of norms on the environment and social aspects based on the international guidelines of the United Nations and the International Labour Organisation.

  The Sustainable Food Laboratory also works on the development of a comprehensible assessment of the most sustainable raw materials for biofuels that enables a useful comparison between the different agriculture raw materials.

  In 2007 a Dutch committee developed sustainable criteria for biofuels. These so-called Cramer Criteria were formalised in March 2009 as the NTA 8080:2009 Sustainability criteria for biomass for energy purposes.[341] In September 2013 the European Parliament had voted in favour of regulation that reduces the obligation to blend biofuels to 6%. The European Parliament thus intends to reduce the $CO^2$ emissions of the cultivation for biofuel.

- ***Cocoa**:* In 2001, the Harkin Engel Protocol was drafted to prevent the worst types of child labour on cocoa plantations. Yet, in recent years various examples of child labour on African cocoa plantations came to light. The chain also suffers from unequal power relations, which leads to small cocoa farmers not receiving reasonable prices. In October 2007 the first meeting of the Roundtable on a Sustainable World Cocoa Economy was held in which farmers, traders, processing companies, governments and social organisations talked about the development of sustainability norms for the cocoa industry. Other initiatives are the World Cocoa Foundation (WCF), which supports programmes for sustainable cocoa farming, and the Sustainable Tree Crops Programme for the development of the sustainable harvest of cocoa, coffee and cashews in Africa. Some certification labels for sustainable cocoa are: Fairtrade Labelling Organizations (FLO) Product Standard, organic (EKO), Utz and Rainforest Alliance (SAN Additional Criteria and Indicators for cocoa).

- ***Coffee:*** For many years, organisations like Max Havelaar and - more recently - Utz Certified have been involved in the certification of coffee. Max Havelaar particularly focuses on small coffee producers and establishes minimum prices for these farmers. The Common Code for the Coffee Community (4C) provides an extensive framework in which both environmental aspects as well as social problems within the coffee industry are covered. For 50 years, the International Coffee Organisation (ICO) has developed standards for responsible coffee. The last ICO agreement was the International Coffee Agreement 2007. There is also a Rainforest Alliance certification mark for coffee, based on the Additional Criteria and Indicators for coffee by SAN. The Fairtrade Labelling Organizations (FLO) also has a Product Standard for coffee.

- ***Tea:*** Tea production is labour intensive and the industry creates jobs in very remote rural areas. Globally, millions of people depend on the production of tea for their income. The price on the world market for tea has fallen dramatically in the past twenty years and, partly due to this, large social problems have arisen in the production of tea. Since 1997 the Ethical Tea Partnership, a joint industry initiative of traders and packers, monitors the working conditions on large plantations. Other certification systems are Fairtrade, Rainforest Alliance and Utz Certified.

- ***Other norms:*** Fairtrade Labelling Organizations (FLO) has also Product Standards for vanilla, fresh fruit and rice. Also, the Sustainable Agriculture Initiative Platform, founded by multinationals in the agricultural industry, develops tools and guidance to support global and sustainable sourcing and agricultural practices. The certification mark Fair Produce is an initiative of producers and trading companies which should improve the disturbed competitive situation in the mushroom industry.

The list described above is not an exhaustive overview of all the certification schemes and agricultural crops. The initiatives also are in various stages of development and have gained different levels of support, from very concrete and widely supported to quite vague and one dimensional. In virtually all industries, effective verification and control systems still have to be developed so that certification becomes waterproof and any progress in the field of sustainability can be measured. Some initiatives already offer reliable norms on which a policy of financial institutions can be based and others provide starting points.

*This leads to assessment element 22 and 23.*

- **Sustainability reporting**

The Global Reporting Initiative has drafted guidelines on how to write sustainability reports. Besides the general G4 Sustainability Reporting Guidelines it also provides sector guidance for a number of industrial sectors. In the Food Processing Sector Supplement (FSSS), guidelines are also included with respect to animal welfare, fair trade, health and the wellbeing of consumers, impact on natural resources and the use of packaging. The guideline has been specifically developed for companies involved in processing food and drinks. Parts of the guideline are also suitable for companies involved on the side, such as suppliers of pesticides, and take all links in the production chain into account. For small and medium enterprises (SMEs), less elaborate sustainability reporting is required. SMEs can report on the GRI indicators that are relevant to their operations, for example by following the High5! Approach.

*This leads to assessment elements 24 and 25.*

- **Procurement and supply chains**

Companies are often part of long production chains. They can monitor one another and question how they respect local and national legislation and international norms regarding social, economic and environmental issues. The requirements that companies set for their suppliers can be included in contractual agreements. The importance of this also recognised in the OECD Guidelines for Multinational Enterprises since its revision in 2011.

Also the ISO 26000 guideline recognises the importance of supply chain responsibility, because “the impacts of an organization's decisions or activities can be greatly affected by its relationships with other organizations.” A companies’ sphere of influence includes relationships within and beyond an organization’s supply chain.[342]

The United Nations Guiding Principles on Business and Human Rights include a due diligence process in order to identify, prevent, mitigate and account for how companies address their adverse human rights impacts. The process “should cover adverse human rights impacts that the business enterprise may cause or contribute to through its own activities, or which may be directly linked to its operations, products or services by its business relationships.”[343]

A useful tool for companies is the FAO-OECD Guidance for Responsible Agricultural Supply Chains. The Guidance “has been developed to help enterprises observe existing standards for responsible business conduct along agricultural supply chains. These standards include the OECD Guidelines for Multinational Enterprises, the Principles for Responsible Investment in Agriculture and Food Systems, and the Voluntary Guidelines on the Responsible Governance of Tenure of Land, Fisheries and Forests in the Context of National Food Security. Observing these standards helps enterprises mitigate their adverse impacts and contribute to sustainable development”.[344] Furthermore, the Guidance contains a step-by-step model for implementing supply chain due diligence in the agricultural sector.

*This leads to assessment elements 26 and 27.*

### 3.4.3 Assessment elements

A reform of the global food and agriculture sector is badly needed in order to improve its contribution to sustainable development and to meeting its responsibility to respect peoples' right to food. Only through sustainable practices the massive deforestation that presently takes place as a result of the growth of agricultural activities can be reduced. This would protect biodiversity and ecosystems, climate change and fight desertification as well as preventing social problems with respect to the land rights of the local populations. Financial institutions play an important role in the food and agriculture sector as they finance producers, processors and traders of agricultural products. On these grounds, financial institutions carry a shared responsibility for improving the sustainability of this sector.

The following elements are crucial for a policy regarding the companies a financial institution invests in or finances:

1. Companies respect the right to adequate food.
2. Companies respect the ILO Declaration on Fundamental Principles and Rights at Work.
3. Companies prevent conflicts over land rights and acquire natural resources only by engaging in meaningful consultation with local communities and obtaining free, prior and informed consent (FPIC) when it concerns indigenous peoples.
4. Companies prevent conflict over land rights and acquire natural resources only with free, prior and informed consent (FPIC) of the land users involved.
5. Companies prevent negative impact on protected areas that fall under the categories I-IV of the International Union for Conservation of Nature.
6. Companies prevent negative impact on UNESCO World Heritage sites.
7. Companies prevent the negative impact on protected areas listed under the Ramsar Convention on Wetlands
8. Activities in the field of genetic materials and genetic engineering only take place if they meet the permission and processing requirements described in the UN Convention on Biological Diversity and the related Bonn Guidelines or Nagoya Protocol.
9. Production of, and trade in, living genetically modified organisms can only take place if permission of the importing country has been obtained and all requirements of the Cartagena Protocol have been met.
10. Production of, or trade in living genetically modified organisms is unacceptable
11. Companies respect the *Five Freedoms* of animals.
12. Very restricted housing methods for calves (in crates), hens (in battery cages) and sows (in feeding cubicles) are unacceptable.
13. Companies reduce the time limit of animal transport to a maximum of 8 hours.
14. Companies reduce their direct and indirect greenhouse gas emissions.
15. Companies reduce their direct and indirect emissions of harmful substances, such as particulate matter, nitrogen oxide and ammonia.
16. Conversion of peatland and high-carbon stocks for agricultural development is unacceptable.
17. Companies use pesticides as little as possible and, if necessary, only in a responsible way.
18. Companies use as little water as possible.
19. Companies prevent water pollution.
20. Companies conduct water scarcity impact assessments and prevent negative impacts in water scarce regions.
21. Companies do not start new operations in areas where water scarcity is pre-existing and operations would compete with the needs of communities.
22. Companies work with relevant standards and initiatives for raw materials (mentioned in section 3.4.2).
23. Companies are certified according to the criteria of the certification schemes for raw materials(mentioned in section 3.4.2).

24. Companies publish a sustainability report that may contain (a number of) Standard Disclosures from the GRI G4 Sustainability Reporting Guidelines.
25. Large enterprises and multinational enterprises in the food industry publish a sustainability report that is set up in accordance with the GRI G4 Sustainability Reporting Guidelines, which includes the Food Processing Sector Disclosure (FSSD).
26. Companies integrate social, economic and environmental criteria in their procurement and operational policies.[xvi]
27. Companies include clauses on the compliance with social, economic and environmental criteria in their contracts with subcontractors and suppliers.

## 3.5 Forestry

### 3.5.1 What is at stake?

About 30% of the surface of the Earth - almost 4 billion hectares - is covered with forests. Of this, about 271 million hectares are timber plantations. Although these have an entirely different function, the plantations are often classified as 'forest'.[345] Forests and plantations play an important role on earth and provide us with a variety of services which are described below.

- It is very difficult to estimate how many people depend on forests for their livelihoods, with important differences between those who live inside forests, those who live near forests and those who are engaged in commercial activities that rely on forests. These categories also overlap and vary along with the definition of 'forest'.[346] Nevertheless, some estimates place the number of people who depend on forests for their livelihood at around 1.6 billion people.[347]
- About 350 million people - of whom 60 million are the original inhabitants of the forest - consider the forest to be their home: their social, cultural, and economic wellbeing is inextricably connected with the forest and the products they find there.[348]
- Forest ecosystems are the most bio-diverse ecosystems on earth, offering shelter to about 70% of all animals and plants living on land.[349]
- Trees grow by extracting $CO_2$ from the air. Untouched forests serve as carbon storage and are therefore invaluable with regard to climate protection.[350] In 2012 a joint study by two of the world's leading research groups presented findings that estimate that deforestation provides 3.0 billion tons of carbon dioxide a year, thus contributing significantly to global warming. This accounts for 10% of global emissions.[351] The IPCC in 2014 estimated the $CO_2$ emissions produced by the agriculture, forestry and other land use (AFOLU) at 12% of global emissions between 2000 and 2009.[352]
- Forests ensure the fertility of the soil, protect reservoirs and reduce the risk of natural disasters such as floods and avalanches because they hold water resources and prevent soil erosion. These properties have a very positive effect on global agriculture productivity and human health.[353]

xvi If the financial institution has no specific sector policies or does not mention this in its sector policies, but does mention this in cross-cutting policies for at least three themes, the financial institution is deemed to comply with this element.

- The forest products industry is a source of economic growth and provides timber and other products, such as edible nuts and fruit, medicinal plants, fibres and rubber. Between 1983 and 2011, the total value of wood products traded in the international market grew from approximately USD 60 billion to over USD 400 billion.[354] The economic importance of the informal, local trade in timber and other forest products is likely to be much higher. Furthermore, the loss of forests also causes damage to the economy. Deforestation and forest deterioration are responsible for costs between EUR 1.5 and EUR 3.4 trillion in the world economy.[355]
- Forestry creates employment, but in this policy there are large differences between the types of forestry. Small scale and informal forestry - often in combination with *agro forestry* - are usually an important source of employment. However, there is a great deal of variation between types of forestry work, within different kinds of forestry work and also between regions.[356]

Despite their importance for human beings and nature, forests are still being destroyed with unprecedented speed. Experts estimate that during the nineties of the last century, about sixteen million hectares of natural forest was lost annually.[357] The United Nations Food and Agriculture Organization (FAO) calculated that between 2000 and 2010 the average net loss of forest per year was 12.8 million acres.[358] The reduction of the net loss is caused by the increase of planting new forests for plantations. Besides deforestation, due to overexploitation there is also a lot of *forest degradation* taking place. This means that forests lose their richness in biodiversity and parts of their social and ecological functions.

Deforestation and forest degradation deprive local communities of their territory and livelihood, lead to loss of biodiversity, soil erosion and a decrease in the surface and groundwater table. In addition, deforestation activities sometimes cause horrible forest fires. Due to air pollution caused by these fires, people can suffer from respiratory problems - such as asthma, bronchitis and pneumonia - as well as other consequences of the fires, such as eye and skin problems. Most forest fires were caused by the destruction of forests for the purpose of expansion of the large-scale pulp industry and palm oil plantations.[359]

Important causes of deforestation and forest degradation are:

- **Non-sustainable and illegal logging.** Non-sustainable logging occurs when forests are cut down so fast that recovery is impossible. Although non-sustainable logging is often illegal, these are two different issues. Not all unsustainable logging is illegal, because the forestry regulations in a lot of countries still fail to take sustainability into account. And not all types of illegal logging are non-sustainable, such as the small scale logging by population groups that live in the forest and depend on small-scale agricultural activities (shifting cultivation).

  Illegal logging and forest crime has an estimated worth of USD 30 billion to USD 100 billion annually, or 10 % to 30 % of the total global timber trade. It is estimated that 50 to 90 % of timber in some tropical countries is suspected to originate from illegal sources or has been logged illegally.[360] Governments would have been able to use this money for the improvement of health provisions, education, and other public services or for the improvement of sustainable forest management systems.

  Also, non-sustainable logging often causes great damage to the environment. Due to the conversion of forests and other bio-diverse areas into timber plantations and secondary (degenerating) forests, biodiversity is lessened.[361] In addition, legal (but non-sustainable) logging exposes the forest to illegal logging and poaching when infrastructure is created.[362]

Non-sustainable logging, which is often illegal, has negative consequences for the livelihood of population groups that depend on forests. Many of these groups are part of the poorest and most oppressed communities in the world. In some forest rich countries, the forestry industry is very corrupt. Private allocations of licenses and payment for these services by large scale logging companies have increased to such an extent that national legislation is being undermined. As a result, democratic governance and attention to human rights have come under pressure. In some cases the illegal exploitation of forests is directly linked to large-scale violent conflicts (such as in the Democratic Republic of Congo) and to the financing of military rule (such as in Burma).[363]

The sale of illegal wood within the EU remains a serious problem. As a report by the European Commission in February 2016 shows, much more needs to be done to combat the trade in illegal timber. The report states that private sector companies had "not consistently implemented the [due diligence] requirements" and that compliance remains "uneven and insufficient".[364]

- **Conversion of natural forests into timber and pulp plantations.** One of the main causes of non-sustainable logging is the establishment of large-scale pulp, paper and veneer factories. The timber mills in these factories produce a great deal of their respective products and these companies generally fail to make use of the sustainable timber supply. Often, large areas of natural forests are cut down to make room for timber plantations on the exposed land that use fast growing types of tree. Although plantations are sometimes classified as forests - for example in the annual FAO study State of the World's Forests - they do not offer the same social and ecological functions as natural forests do.

  About 42% of global logging is destined for industrial paper use and pulp factories are becoming increasingly controversial. The huge monoculture plantations needed to supply modern pulp factories with raw material have serious consequences for biodiversity, water quality, land rights and income provision. Due to this, the factories themselves are very polluting. Stimulated by financial institutions, the industry constructs larger factories than needed, as it is easier to obtain financing for a large factory than for a small one. Financial institutions can therefore exert significant influence in determining which projects ultimately go ahead.[365]

  **Conversion of forests for agriculture.** Agricultural activities in livestock farming and the production of palm oil, soy and corn (for food and biofuel) increasingly use larger and larger land areas. To make way for agricultural activities, forests are cut on a large scale, after which the remaining vegetation is burnt to serve as fertiliser. This system is commonly known as *slash-and-burn*. It is mostly conducted by farmers, however these activities are sometimes connected to large industry players.[366]
- **Conversion of mangroves for fish farming.** Also, for large-scale fish and shell fish growers, forests - in this case mangroves in tropical coastal areas - are destroyed.

- **Development of large-scale industrial and infrastructure projects.** For the development of industry and infrastructure - such as roads, railways, channels, dams, mines, oil and gas plants and pipelines - forests are destroyed.

According to a case study by the World Bank, to date the forestry industry has contributed too little to the preservation and management of the forests on earth. Instead "Industrial timber production has a poor track record in Africa. Over the past sixty years, there is little evidence that it has lifted rural populations out of poverty or contributed in other meaningful and sustainable ways to local and national development."[367] With respect to the management of forests in Cambodia, the Inspection Panel of the World Bank concluded "one could hardly overemphasise the negative effects of logging on a natural habitat of world class value and most importantly on very poor and vulnerable rural communities and indigenous peoples.".[368]

The United Nations Collaborative Programme on Reducing Emissions from Deforestation and Forest Degradation in Developing Countries (UN-REDD) is an initiative whereby developing countries are financially stimulated to reduce the emission of greenhouse gases due to deforestation and to invest more in sustainable development. During the 15th United Nations Climate Change Conference in Copenhagen in December 2009, the Copenhagen Accord agreement was achieved on the need to stop deforestation and forest degradation.

This section deals with the forestry industry, which comprises of all companies that manage forests and plantations and the companies that process timber (lumber, pulp, paper, and other wood products). The forestry industry is also comprised of all companies that are involved in trade and the further processing of these products, such as furniture, and therefore exists of long chains with a lot of different companies in which financial institutions can invest. As well as having a large influence on the state of the forests in the world, the forestry industry also depends on it. Therefore, the forestry industry deserves a separate policy, besides the investment policy for other industries that contribute to deforestation and forest degradation (such as agriculture, fishing and mining).

Financial institutions should develop a stringent investment policy to themselves ensure that they only invest in or finance companies and governments that manage their forests in a way that is not only sustainable for the environment, but is also beneficial to local societies.When developing a policy for this industry, financial institutions can make use of the international standards described below.

### 3.5.2 International standards

The most important international standards and initiatives for the forestry industry are:

- **Protected areas and High Conservation Value Forests**

  Forestry activities in all protected areas that fall within the categories I-IV of the World Conservation Union, the UNESCO World Heritage Convention and the Ramsar Convention on Wetlands require special attention and protection. These areas are dealt with extensively in section on nature. Policies of financial institutions have to be aimed at avoiding investments in forestry activities in these areas.

  These areas are also included in the analyses for investments by International Finance Corporation's (IFC) Performance Standard 6 concerning Biodiversity Conservation and Sustainable Management of Living Natural Resources. It determines how companies should operate in order to avoid negative consequences on areas of high biodiversity value, including impact on natural habitats as well as endangered and endemic species. The requirements in the standard have been guided by the Convention on Biological Diversity.

  In addition, FSC has developed the High Conservation Value Forests (HCVFs) concept. HCVFs describe forest areas with special attributes that make them particularly valuable for biodiversity and/or local people, and are defined as “natural landscapes of which the conservation value - including the presence of rare animal species and sacred sites have traditional importance to local or indigenous people.” the objective of assigning an HCVF-label to certain forest areas is to be able to better identify valuable forests, developing suitable protection so important ecological and social economic values remain preserved.[369] The Global HCVF Toolkit, developed by IKEA and ProForest, provides starting points to apply the concept and implementation on a national scale. Organisations supporting HCV Resource Network HCV Charter can register.

  *This leads to assessment element 1.*

- **High Carbon Stock**

  Different forests have different degrees of carbon storage. The High Carbon Stock (HCS) Approach is a methodology to identify areas of land suitable for plantation development and forest areas that can be protected in the long term. The methodology distinguishes natural forest areas from degraded lands (former forest) that now contain only small trees, shrubs or grasses. HCS forests store a lot of carbon that would be released if converted into plantations, as well as having rich biodiversity values. The methodology was originally developed by Greenpeace, The Forest Trust (TFT) and Golden Agri-Resources (GAR), and is now governed and will be further refined by a multi-stakeholder body called the High Carbon Stock Approach Steering Group. The HCS Approach is now used by plantation companies that have made a commitment to exclude deforestation from their supply chains.[370]

  *This leads to assessment 2.*

- **Illegal logging and deforestation**

  Since 2002, governments of wood producing and consuming countries have organised a number of conferences together with the World Bank. These Ministerial Conferences on Forest Law Enforcement and Governance (FLEG) processes are aimed at reducing illegal logging and the respective trade and corruption in the forestry industry. In order to reach these objectives producers, consumers and donor governments are held accountable to international commitments to increase their efforts. Up to now, FLEG-meetings have taken place in South-East Asia and Australia, Africa, Europe and in North Asia.

  In May 2003, the European Commission developed the Forest Law Enforcement, Governance and Trade (FLEGT) Action Plan, which was adopted by the EU in 2004. The FLEGT Action Plan establishes a new and innovative approach to prevent illegal logging. This means that legal agreements within the EU that concern trade and exploitation of raw materials are linked to the governance of the developing countries where these raw materials (in this case wood) come from. The action plan describes a series of measures - such as supporting the private industry by keeping illegal timber out of the chain - and it supports measures to prevent investments in illegal logging.

  In 2008, the United States were the first country to ban the import, sale and trade of illegal timber and other related products. According to the Lacey Act, importers have to indicate the wood species and the country of origin of most wood species, with heavy fines on importing wood products from illegal sources, regardless of whether this is done intentionally or unintentionally.[371]

  In March 2013, the EU Timber Regulation (EUTR) came into force: “Placing illegally harvested timber and products derived from such timber on the EU market for the first time, is prohibited. EU operators – those who place timber products on the EU market for the first time – are required to exercise ‘due diligence’. Traders – those who buy or sell timber and timber products already on the market – are required to keep information about their suppliers and customers to make timber easily traceable.” Companies can develop their own Due Diligence System or make use of the services of monitoring organisations across the EU.

Several very large companies, notably traders in the palm oil sector such as Archer Daniels Midland and Wilmar International (the latter controls roughly 45% of the global market in palm oil), have adopted 'no deforestation' policies in recent years. These policies set a high benchmark, often allowing no deforestation, no peat development and no conflicts, in their own operations or in their supply chain. Although in these first cases directed at the palm oil sector, financial institution may apply the policies to other sectors causing deforestation, peat loss and conflicts as well.[372]

The United Nations Climate Summit's New York Declaration on Forests has been signed by several large companies. The Declaration is a non-legally binding political declaration, which aims to cut natural forest loss with 50% by 2020 and to ultimately end deforestation by 2030. Furthermore, it also promotes the restoration of forests and croplands of an area larger than India. The Declaration has been endorsed by dozens of governments, 30 of the world's largest companies and over 50 influential civil society and indigenous organisations. The associated voluntary Action Agenda serves as a guide to governments, companies, and organisations regarding the diverse set of actions that can achieve these transformational goals.[373]

The Soft Commodities Compact initiative of the banks involved in the Banking Environment Inititative (BEI) and the Consumer Goods Forum (CGF) aims "to lead the banking industry in aligning with the CGF's resolution to help achieve zero net deforestation by 2020".[374] The commitments of the banks include: "Alongside their own due diligence processes, by 2020 Compact banks will confirm that these customers' operations have achieved the same internationally-recognised means of verification that the CGF is prioritising. For each commodity, the starting point is: [375]

- Roundtable on Sustainable Palm Oil (RSPO) certification for palm oil;
- Forest Stewardship Council (FSC) verification or that of a national scheme endorsed against the 2010;
- Programme for the Endorsement of Forest Certification (PEFC) meta standard for timber products;
- Round Table on Responsible Soy (RTRS) certification for soy".

*This leads to assessment element 3.*

- **Pulp and paper production**

In 2014 a group of over 120 non-profit organizations endorsed a new Global Paper Vision, to improve sustainability in the paper supply chain. The Global Paper Vision encompasses seven principles, addressing the entire paper life-cycle:

- reduce global paper consumption and promote fair access to paper;
- maximise recycled fibre content;
- ensure social responsibility;
- source fibre responsibly;
- reduce greenhouse gas emissions;
- ensure clean production; and
- ensure transparency and integrity.

*This leads to assessment element 4.*

- **Fair and equal use of forests**

  In article 8(j), the Convention on Biological Diversity (CBD) also considers the fair and equal use and the advantages of biological diversity and requires that traditional knowledge of indigenous and local communities can only be used with their permission. The Akwé: Kon Guidelines require the conduct of cultural, environmental and social impact assessments regarding developments proposed to take place or which are likely to impact on sacred sites and on lands and waters traditionally occupied or used by indigenous and local communities.

  *This leads to assessment element 5.*

- **Land rights, conflicts and forced evictions**

  The right to food, water, housing and work are included in the International Covenant on Economic, Social and Cultural Rights (ICESCR).[376] These rights are connected to the non-defined right to land.

  Regarding adequate housing, governments have the obligation to guarantee security of tenure, which includes protection against forced eviction.[377] As noted by the UN Special Rapporteur on Adequate Housing: "Involuntary resettlement amounts to a forced eviction when it occurs without the provision of, and access to, appropriate forms of legal or other protection."[378] The protection measures that should be applied to all evictions are articulated in the Basic Principles and Guidelines on Development-based Evictions (2007), developed by the UN Special Rapporteur on Adequate Housing.[379] They reflect existing standards and jurisprudence on this issue, including detailed guidance on steps that should be taken prior to, during and following evictions in order to ensure compliance with relevant principles of international human rights law.

  The 11 core principles of the United Nations Special Rapporteur on the right to food, include the notion that any shifts in land use can only take place with the free, prior and informed consent of the local communities concerned. This is particularly important for indigenous communities, in view of the discrimination and marginalization they have been historically subjected to.

  In May 2011, the Tirana Declaration was adopted by over 150 representatives of civil society organisations, social movements, grassroots organizations, international agencies, and governments. According to The Declaration land acquisitions or concessions should, amongst others, be based on free, prior and informed consent of the affected land-users.

  *This leads to assessment elements 6 and 7.*

- **Certification of forest management and the wood product chain**

  The Global Paper Vision emphasises the importance of responsible sourcing "from forest managers that have credible, independent, third-party certification for employing the most environmentally and socially responsible forest management and restoration practices".[380]

Most certification schemes developed to guarantee sustainable forest management, fail in developing and monitoring strict guidelines. Often, this has to do with the involvement of companies from the forestry industry ain the certification process. Due to the fact that these companies have a commercial interest in weak certification guidelines, their participation in the process merely enhances the status quo of non-sustainable forest management. This is reflected in the fact that most certification methods do not respect the rights of indigenous peoples and exclude them from the decision-making process and decisions.[381]

There are two certification systems that include this topic in their standards: the Forest Stewardship Council (FSC) and the Program for the Endorsement of Forest Certification (PEFC).

In the FSC forest owners, forest construction companies, labour unions, social and environmental organisations are represented. The FSC has drafted the 10 Principles of Forest Stewardship. With the corresponding criteria, these principles form the basis of all FSC standards for forest and plantation management. By now, 180 million hectares of forests and plantations in about 80 countries have been certified according to the FSC standards, and managed by 1229 certificate holders. In addition, 27,000 wood products carry the FSC Chain of Custody-certificate, which implies that the entire production chain complies with FSC conditions.[382]

The PEFC criteria also includes requirements that the UN Declaration on the Rights of Indigenous Peoples is observed (including the so-called Free and Prior Informed Consent principle). The PEFC certificates (16,000 companies have a Chain of Custody certificate) are mainly issued in Europe (84%).[383] No less than 60% (151 million hectares) of PEFC-certified wood comes from North America. Europe follows with 33% (84 million hectares).[384]

Civil society organizations (CSOs) WWF, Greenpeace, Friends of the Earth and the Dutch Centre for Indigenous Peoples (NCIV) have advised against approval of the Malaysian Timber Certification Scheme (MTCS). According to the CSOs, in MTCS certified woods transformation of forest takes place and constant social conflicts on land rights. Areas for improvement within the PEFC and MTCS management standards include exclusion of natural forest conversion, safeguarding High Conservation Values, better producer communication and addressing greenhouse-gas emissions. MTCS should also better address indigenous peoples' rights and community relations.[385]

This illustrates that because PEFC certification takes place on the basis of national standards, it is not possible to derive clear criteria from a PEFC certificate. Among nature and environmental organizations there is unanimity that PEFC standards do not ensure sustainable forestry, especially outside Europe. The Global Paper Vision also states that FSC is currently the only international certification programme meeting their requirements of a good certification programme. Friends of the Earth Netherlands determined unsustainable forestry in 2009 in the United States, Australia and Slovakia in PEFC - certified forests.[386] In addition there are, according to WWF and Greenpeace, among others, the following weaknesses of PEFC compared to FSC:[387]

- Woodlands can be converted to monoculture plantations;
- No need to protect endangered plant and animal species; and
- The organization is dominated by the timber industry and there is too little involvement of other stakeholders.

Nevertheless, the Dutch Ministry of Environment has established that both FSC and PEFC (except the Malaysian MTCS-certificate) ensure sustainable wood.[388]

However, Fair Finance Guide International considers PEFC certification for non-tropical wood not a sufficient requirement from companies. As PEFC certification for tropical wood does not meet the standards to ensure production of sustainable wood, FSC certification is preferred.

*This leads to assessment elements 8 and 9.*

- **Sustainability reporting**

  In September 2003 the World Wildlife Fund (WWF) published Guidelines for Investment in Operations that Impact Forests. These guidelines help financial institutions to identify critical problems in the forestry industry and to develop a forestry policy.
  The recently launched Forest Footprint Disclosure (FFD) project tries to help investors in identifying links between tropical deforestation and the activities and chains of the companies in which they invest. Similar to the Carbon Disclosure Project, questionnaires are sent on behalf of institutional investors. The results - which indicate whether a company has developed 'best in class' in innovative risk control strategies, or did not respond to the request to make its forest footprint public - are collected in an annual report.[389]

  The Global Reporting Initiative has set up the G4 Sustainability Reporting Guidelines for writing sustainability reports. For small and medium enterprises (SMEs), less elaborate sustainability reporting is required. SMEs can report on the GRI indicators that are relevant to their operations, for example by following the High5! Approach.

  *This leads to assessment elements 10, 11 and 12.*

- **Procurement and supply chains**

  Companies are often part of long production chains. They can monitor one another and question how they respect local and national legislation and international norms regarding social, economic and environmental issues. The requirements that companies set for their suppliers can be included in contractual agreements. The importance of this is also recognised in the OECD Guidelines for Multinational Enterprises since its revision in 2011.

  Also the ISO 26000 guideline recognises the importance of supply chain responsibility, because "the impacts of an organization's decisions or activities can be greatly affected by its relationships with other organizations." A companies' sphere of influence includes relationships within and beyond an organization's supply chain.[390]

  The United Nations Guiding Principles on Business and Human Rights include a due diligence process in order to identify, prevent, mitigate and account for how companies address their adverse human rights impacts. The process "should cover adverse human rights impacts that the business enterprise may cause or contribute to through its own activities, or which may be directly linked to its operations, products or services by its business relationships."[391]

  *This leads to assessment elements 13 and 14.*

### 3.5.3 Assessment elements

Financial institutions can use their influence to prevent deforestation and forest degradation. Financial institutions can do so by establishing a strict policy for investments in the forestry sector. This policy applies to the entire forestry sector, being forestry, logging, pulp, paper and furniture production as well as other wood processing and trade companies.

The following elements are crucial for a policy regarding the companies a financial institution invests in or finances:

1. Forest construction companies identify and protect the High Conservation Value (HCV) areas within the forests they manage.
2. Companies identify and protect High Carbon Stock (HCS) forests.
3. Companies throughout the wood supply chain prevent the use of illegally cut and traded timber.
4. Pulp and paper factories restrict the use of chemicals and the pollution of soil, water and air by making use of the best available techniques.
5. Companies respect the rights of local and indigenous communities on the fair and equal use of forests.
6. Companies prevent conflicts over land rights and acquire natural resources only by engaging in serious consultation with local communities and obtaining free, prior and informed consent (FPIC) when it concerns indigenous peoples.
7. Companies prevent conflict over land rights and acquire natural resources only with free, prior and informed consent (FPIC) of the land users involved.
8. Production forests and timber plantations are certified according to the criteria of the Forest Stewardship Council (FSC).
9. Production chains of timber traders and companies in the wood product chain (including pulp, paper, veneer, furniture) are certified according to the FSC Chain of Custody criteria.
10. Companies in industries with a large impact on forests (including in any case the forestry and paper industry), report their *forest footprint* to the Forest Footprint Disclosure (FFD) project.
11. Companies publish a sustainability report that may contain (a number of) the Standard Disclosures from the GRI G4 Sustainability Reporting Guidelines.
12. Large enterprises and multinational enterprises publish a sustainability report that is set up in accordance with the GRI G4 Sustainability Reporting Guidelines.
13. Companies integrate social, economic and environmental criteria in their procurement and operational policies.[xvii]
14. Companies include clauses on the compliance with social, economic and environmental criteria in their contracts with subcontractors and suppliers.

## 3.6 Housing and real estate

### 3.6.1 What is at stake?

The built environment has direct and indirect impacts on social wellbeing and the livelihoods and prosperity of local communities and individuals. It provides homes, jobs, education and recreational facilities for communities. During its lifecycle – design, construction, occupation, renovation and demolition – a building has various impacts on the environment, on society and on the human rights of various groups, including construction workers, occupants and the surrounding communities.

xvii If the financial institution has no specific sector policies or does not mention this in its sector policies, but does mention this in cross-cutting policies for at least three themes, the financial institution is deemed to comply with this element.

With respect to the environmental impact of real estate, the UN Environment Programme (UNEP) estimates that, throughout their life-cycle, buildings account for roughly 40% of all global energy consumption as well as 25% of all water resource withdrawals. Buildings are also responsible for 30% of word-wide and 36% of European Union greenhouse gas emissions.[392]

As a consequence, the real estate sector has the potential to play a significant role to mitigate climate change through reduction of GHG emissions in the built environment.[393] For example, energy consumption could be reduced by as much as 80% using established and new technologies.[394] Within the European Union, currently, about 35% of the buildings are over 50 years old. The European Commission estimates that by improving the energy efficiency of buildings, total EU energy consumption could be reduced by 5% to 6% and $CO_2$ emissions by about 5%.[395]

For real estate investments, improving sustainability can therefore be very profitable. The operating costs of buildings are exposed to fluctuations in energy prices and possible tax effects, due to future regulations regarding energy use and the emission of greenhouse gases.[396] If buildings are constructed to be energy efficient or adapted to be so, this can reduce the operating costs by up to 25 to 30%.[397] This also helps to respond to market developments. It is expected that the demand for sustainable real estate will increase significantly in the coming years.[398] In addition, energy efficient buildings have a higher economic value.[399]

In terms of environmental sustainability and resource efficiency, it is important to consider the entire life-cycle of a building: from siting, design, construction, use, maintenance and renovation to demolition:[400]

- Environmental impact of the building design and site location;
- Sustainability and resource efficiency during construction;
- The sustainability and resource efficiency of the completed building; and
- How renovation and demolition of a building takes place.

In relation to siting and design, it is important to consider:

- Possible impact of new buildings on local ecosystems, habitats and land, air and water quality (e.g. disruption of animal populations, clearing trees, filling up waterways);
- Environmental sustainability of location (e.g. proximity to public transport);
- The environmental footprint and sustainability of the materials used for construction, such as wood, cement and metals, which involves taking into account not only the type of material and how it is produced, but also where it is sourced and transported from and what environmental consequences this has, such as water use, GHG emissions and pollution (responsible supply chain management);
- Availability and utilisation of renewable energy resources such as wind and solar power for heating and ventilation;
- Use of recycled materials and recyclability of used materials (cradle-to-cradle concept); and
- Clustering buildings together and redeveloping brownfields.

Relevant aspects during the construction phase are:

- The environmental impact of a new building on the chosen site and surrounding area, including pollution and the disruption of ecosystems through building activities (e.g. noise and waste, creating access roads);
- The impact of the building methods related to machinery, tools and materials (e.g. water use and pollution, avoiding toxic chemicals).

For the environmental sustainability of the completed project, three dimensions are important:[401]

- Energy preservation by means of energy efficient solutions, use of sustainable energy sources and the presence of sufficient daylight and natural ventilation;
- Minimal disruption of ecosystems in surrounding area (e.g. water recycling and harvesting to limit demands on local aquifers if they are stressed); and
- Minimal production of waste and controlling harmful by-product effects (e.g. soil erosion or waterway sedimentation).

When a building is renovated or broken down, environmental impacts include:

- Pollution: does renovation or demolition result in environmental pollution (water, air, noise)?
- Waste management: what happens to the materials from the renovated/demolished building? (e.g. In the EU the building sector produces one third of all waste);[402]
- Materials: how environmentally sustainable are the materials used in renovation? and
- Methods: how environmentally sustainable are the renovation/demolition methods?

The housing and real estate sector is also intertwined with several *human rights and social issues*. During the construction stage these include health and safety considerations, fair wages, reasonable working hours, indenture or forced labour and other workers' rights violations for construction workers.[403]

Human rights violations can also occur through the (in)voluntary displacement and resettlement of people living on - or nearby - land that is to be developed for buildings. Whether voluntary or involuntary, potential impacts may include loss of productive land, loss of employment and income, loss of housing, loss of access to common resources and public services, and social fragmentation.[404]

The right to adequate housing also requires that health and safety standards are respected in design, construction, maintenance, renovation and demolition of buildings, in order to protect the occupants and users of buildings. When planning new buildings and living areas, companies should not only consider how to make sustainable buildings but also how urban areas can be designed in such a way that shops are within walking distance, that there is sufficient green space and parks and that there is enough space for vehicles, bikes and pedestrians.

### 3.6.2 International standards

The housing and real estate sector has impact on material use, climate change and energy use, on human rights of specific groups and on society at large. To address these impacts in their credit and investment policies, financial institutions can make use of the following international standards:

- **Circular economy in real estate**

  Companies active in the housing and real estate sector are expected to take into account the concept of circular economy into their business activities. The concept of circular economy is based on the following principles:[405]

  - All materials are recycled infinitely;
  - All energy is derived from renewable or otherwise sustainable sources;
  - Human activities support ecosystems and the rebuilding of natural capital;
  - Resources are used to generate value (financial and other forms);

- Human activities support human health and happiness; and
- Human activities support a healthy and cohesive society and culture.

The housing and real estate sector can have an important impact in working towards a circular economy. Not only by using sustainable construction materials, but also by re-using, repairing, refurbishing and recycling construction materials/waste in the most sustainable and responsible way possible. Furthermore, as this sector is highly energy intensive, actors are encouraged to make use of renewable or otherwise sustainable energy sources. Finally, the impact of construction projects on ecosystems should be minimised and where possible damage to nature should be restored.[406]

As the building environment can last for decades, in order to avoid vacancy, real estate needs to be designed for multiple and flexible use. Financial institutions can also contribute to transformation of vacant buildings. [407]

*This leads to assessment element 2, 3, 4, 8, 9, 10, 11, 12, 15 and 16.*

- **Certified sustainable wood**

In the construction industry a lot of wood is used. The use of certified responsible and sustainable wood guarantees that the wood is produced in a sustainable way, with preservation of biodiversity and good social criteria. Also, the role of forests for carbon sequestration is protected. It is therefore important that construction companies are certified according to the Forest Stewardship Council (FSC) criteria.

For more information see also the sector theme Forestry in section 3.5.2.

*This leads to assessment element 2.*

- **Certified sustainable cement**

Cement is an important component of concrete and is used extensively in the construction industry. Cement and concrete production has a large environmental footprint, accounting for roughly 8% of global $CO_2$ emissions.[408] However, there is a lot of potential to increase energy efficiency and to use less harmful, alternative materials in concrete production.[409] Concrete and cement production companies can cooperate with the World Business Council for Sustainable Development's Cement Sustainability Initiative, which strives towards improving the impacts of cement and implement the Cement Action Plan. On a country level, the building industry can adopt standardisation programmes for sustainable cement.[410]

Companies can also choose to buy cement from producers who have obtained an Environmental Product Declaration (EPD). An EPD is a voluntary declaration that provides quantitative information about the environmental impact of a product, using life-cycle assessment (LCA) methodology and verified by an independent third party. At the COP21 in December 2015, members of the WBCSD Cement Sustainability Initiative pledged to reduce their $CO_2$ emissions by 20-25% by 2030, as part of a new action plan.[411]

*This leads to assessment element 4.*

- **Energy saving**

  Energy saving in housing and real estate contributes to mitigating climate change. Energy saving measures also reduce energy costs and improves the comfort of houses and other real estate. As part of wider efforts to implement the Paris Climate Agreement of 12 December 2015, real estate asset owners, investors and stakeholders can actively manage the environmental, social, governance (ESG) and climate-related risks of their real estate portfolios and reduce energy use and carbon pollution. In February 2016, PRI and the United Nations Environment Programme Finance Initiative (UNEP FI), together with stakeholders from the real estate sector and real estate investment community, launched the Sustainable Real Estate Investment Action Framework Implementing The Paris Climate Agreement. According to the action framework, real estate investment managers, property owners, asset owners and investors in equity, bonds and debts, should set quantitative and material targets to reduce energy, to use clean energy, to improve energy efficiency and monitor results.[412]

  The UNEP Sustainable Buildings and Construction Initiative has developed a number of options to reduce the $CO_2$-emissions of buildings.[413] The main options are: [414]

  - Enlarging the energy efficiency of new and existing buildings, both of the building itself as well as the systems in the buildings for controlling of heat, ventilation, air conditioning etc. Here it is important that the climate systems are tailored to the structure of the building for optimal performance. Where buildings are delivered including furnishings ("turn-key"), a lot can be done to improve the energy efficiency of computers, lighting, telecommunication systems, kitchen appliances etc.

  - Purchasing electricity that is generated with sustainable energy sources and/or combined with self-generation of electricity with solar panels is also important to consider. In addition, requirements can be made for the location. If there is easy access to public transport close to the buildings, this can significantly reduce car traffic and the respective negative effects on the environment.

  In the EU, the 2010 Energy Performance of Buildings Directive (EPBD) and the 2012 Energy Efficiency Directive (EED) are the EU's main legislation on regarding energy consumption of buildings.[415] The EPBD directive requires all new buildings to be nearly zero-energy by the end of 2020. All new public buildings must be nearly zero-energy by 2018.

  The EU EPBD requires member states to develop legislation regarding the following:

  - Energy performance certificates are to be included in all advertisements for the sale or rental of buildings;
  - EU countries must establish inspection schemes for heating and air conditioning systems or put in place measures with equivalent effect;
  - EU countries must set minimum energy performance requirements for new buildings, for the major renovation of buildings and for the replacement or retrofit of building elements (heating and cooling systems, roofs, walls, etc.); and
  - EU countries have to draw up lists of national financial measures to improve the energy efficiency of buildings.

  In the Netherlands, the National Energy Agreement ("Nationaal Energieakkoord"), an agreement between organisations of employers, employees and civil society organizations, set an energy target for the built environment as a whole, not only new and public buildings, to become energy efficient and to have average Energy label A in 2030.[416]

The EU EED is aimed at increasing energy efficiency and decreasing energy use in national buildings in member states: [417]

- EU countries make energy efficient renovations to at least 3% of buildings owned and occupied by central government;
- EU governments should only purchase buildings which are highly energy efficient; and
- EU countries must draw-up long-term national building renovation strategies which can be included in their National Energy Efficiency Action Plans.

The requirements for and implementation of energy performance certificates vary across the European Union.[418] In the Netherlands, in which a similar system for energy performance already existed in 2010, the EPBD Directive has been transposed via the administrative orders Decision Energy Performance Buildings (Besluit energieprestatie gebouwen, BEG) and Rules Energy Performance Buildings (Regeling energieprestatie gebouwen (REG). Already from January 2008 onwards, owners of homes and other buildings in the Netherlands are obliged to submit an energy performance certificate (Energy label) when selling or renting out, which provides insight into the energy efficiency of the respective building. This certificate ranges from class A++ (highly energy efficient) to class G (the least energy efficient) and provides information on the amount of energy the building normally uses based on a calculation.[419]

Since 2015, according to the Dutch Building Code, the requirements for new buildings have been raised. Depending on their function, buildings need to have an Energy Performance Coefficient (EPC) of for example 0.4 (residential), 0.8 (utility), and 1.7 (retail).[420]

As part of the National Energy Agreement, Aedes, the Dutch branch organisation of social housing corporations in the Netherlands, set the target to improve the average energy efficiency of the total social housing stock to energy class B by 2020. Currently, 24% of the social housing stock has energy class B or higher, meaning that over 75% has energy class C-G. In order to achieve the ambitious Aedes’ target, 1.8 million rental houses in the social housing sector need to have an energy efficiency performance of on average energy label B before 2021. Front-runners in the social housing sector realize affordable renovation projects improving the energy efficiency class of houses from G-E to A.[421]

*This leads to assessment elements 10, 11, 12, 15, 16 and 24.*

- **Sustainable reconstruction after disasters**

The UNEP Sustainable Buildings and Construction Initiative set up a guidance note in 2012 with regard to sustainable reconstruction of houses after disasters. This Sustainable Reconstruction in Disaster-Affected Countries-guidance note asks companies that are involved in the reconstruction to take into account the emissions of greenhouse gases and also energy efficiency. It also points out the social and economic dimensions of reconstruction. This involves, amongst others, jobs for the local populations and the affordability of houses.[422]

*This leads to assessment element 6.*

- **Sustainable neighbourhoods**

Real estate and housing projects should be geared towards creating sustainable and liveable neighbourhoods. This means that in developing real estate and housing projects, attention is paid to green zones, connection to public transport and facilities, such as stores, libraries and hospitals.

In the initial phase of a real estate project, real estate developers and housing corporations are expected to take into account the Five Principles of sustainable neighbourhood planning as stated by United Nations Habitat. The Five Principles are meant to encourage sustainable urban development by creating liveable and efficient neighbourhoods. The Five Principles are: [423]

- Adequate space for streets and an efficient street network: The street network should occupy at least 30 per cent of the land and at least 18 km of street length per km²;
- High density: At least 15,000 people per km², that is 150 people/ha or 61 people/acre;
- Mixed land-use: At least 40 per cent of floor space should be allocated for economic use in any neighbourhood;
- Social mix: The availability of houses in different price ranges and tenures in any given neighbourhood to accommodate different incomes; 20 to 50 per cent of the residential floor area should be for low cost housing; and each tenure type should be no more than 50 percent of the total. Furthermore, the availability of suitable houses for elderly and disabled peoples should be part of the social mix; and
- Limited land-use specialisation: this is to limit single function blocks or neighbourhoods; single function blocks should cover less than 10 per cent of any neighbourhood.

The objectives of these five principles are to:[424]

- Promote high density urban growth, alleviate urban sprawl and maximise land efficiency;
- Promote sustainable, diversified, socially equal and thriving communities in economically viable ways;
- Encourage walkable neighbourhoods and reduce car dependency;
- Optimise use of land and provide an interconnected network of streets which facilitate safe, efficient and pleasant walking, cycling and driving;
- Foster local employment, local production and local consumption; and
- Provide a variety of lot sizes and housing types to cater for the diverse housing needs of the community, at densities which can ultimately support the provision of local services.

*This leads to assessment element 7.*

- **Certification of sustainability performance**

To measure performance regarding sustainability, the real estate industry increasingly uses certifications schemes. Building Research Establishment Environmental Assessment Method (BREEAM) is a methodology for assessing the sustainability achievement of buildings and fields. In this certification process not only the energy consumption of premises is considered, but also land use, ecology, the construction process, water use, waste, pollution, transport, materials, health and comfort. Within BREEAM, country specific certification schemes are possible in some European countries. There are schemes for existing buildings (refurbishment and fit-out), in-use buildings, new buildings and for communities.[425] In the Netherlands, the Dutch Green Building Council is responsible for the certification of BREEAM-NL.[426]

Leadership in Energy & Environmental Design (LEED) is an initiative from the United States promoting environmentally sound construction. The non-profit organisation U.S. Green Building Council applies this certification system globally. "LEED provides building owners and operators with a framework for identifying and implementing practical and measurable green building design, construction, operations and maintenance solutions".[427] The rating systems address construction and renovation of (among others) schools, retail buildings, healthcare buildings, commercial interiors, homes and neighbourhood development. Projects can earn points in the ranking system by satisfying green building requirements: sustainable building sites, water efficiency, energy performance, using sustainable material and waste reduction.

Another certification scheme is the German Sustainable Building Certificate (DGBN), designed by the German Sustainable Building Council,[428] which provides an objective description and assessment of the sustainability of buildings and urban districts. Quality is assessed comprehensively over the entire life cycle of the building. The DGNB Certification System can be applied internationally.[429] The system is based on voluntarily outperforming the concepts that are common or usual today.

For investments through real estate funds, the Global Real Estate Sustainability Benchmark can be adhered to. This study has assessed 543 real estate funds on sustainability policy and implementation. Of only a few dozens of the best ranked funds, the scores are not public but disclosed to investors and participants.[430] Another initiative to aid investors in the integration of sustainability criteria and climate risks into real estate investments, is the Investor framework of the UNEP Finance Initiative, set up in cooperation with CERES - INCR, IGCC, IIGCC, PRI and the RICS.[431]

The Greenprint Principle is a US cooperation of real estate companies that strive to reduce their climate impact. In July 2012, the second edition of the Greenprint Performance Report was published, which measures and compares energy use and $CO_2$ emissions of buildings in 44 countries with a total surface of 75 million $m^2$.[432]

In the Netherlands, the Green Performance of Real estate (GPR) software is a tool which can be used to design or assess the sustainability of buildings or the built environment.

*This leads to assessment elements 13, 14, 15, 16 and 17.*

- **Fundamental labour rights**

  Observing fundamental labour rights is a big challenge in the construction industry. The most important standard in this field is the ILO Declaration on Fundamental Principles and Rights at Work from 1998, in which the ILO stated four fundamental principles and rights at work:

  - Freedom of association and the right to collective bargaining;[433]
  - Banning of all types of forced labour;[434]
  - Banning child labour;[435] and
  - Banning discrimination (based on ethnicity, gender, and social background) with respect to offering work or specific positions.[436]

Another leading ILO document is the Tripartite Declaration of Principles Concerning Multinational Enterprises and Social Policy, of which in March 2006 the fourth revised edition was published. The Tripartite Declaration focuses on the responsibility of companies and specifically on their dealings with labour issues. Besides the reaffirmation of the four fundamental principles - rights on freedom of association and collective bargaining and the ban on discrimination, child labour and forced labour -, the agreement calls upon companies to improve working conditions, develop opportunities to improve equal chances and treatment to provide the best possible wages and fringe benefits for employees.

For the housing and real estate sector, of special importance are ILO conventions concerning excessive working hours and health and safety risks for labourers in the building sector:

- No. 155 concerning Occupational Safety and Health in the Working Environment, 1981;
- No. 1 concerning Hours of Work (Industry) Convention, 1919; and
- No. 167 concerning Safety and Health in Construction, 1988.

Within the European Union the Health and Safety at Work Directives are the framework for national legislation on occupational health and safety.

*This leads to assessment element 1.*

- **Relocation**

Construction companies and real estate corporations should take into account the relocation of people who lose their homes as a result of new building activities. The United Nations has introduced a ban on forcing people to move, based on the human right to adequate housing.[437]

In 2007 the special UN rapporteur for Human Rights set up a document which stipulates how companies and governments should act in cases of relocation. In Basic Principles and Guidelines on Development-based Evictions and Displacement the UN rapporteur describes strategies that should prevent people from being forced to leave their homes. In cases that forced departures do occur, the document provides guidelines for temporary housing and relocation.[438] It is important that not only companies that are involved in real estate construction live up to these standards but also companies that are involved in the demolition of houses. Construction companies that demolish existing homes or that build on places where homes were torn down, must also comply with the UN standard.

*This leads to assessment element 18.*

- **Good landlordship**

Financial institutions and real estate companies can be expected to comply with basic notions of good landlordship. UN Habitat considers security of tenure, adequate basic infrastructure, such as water supply, sanitation and waste-management facilities, as well as adequate security (all of which should be available at an affordable cost), to be a part of the human right to adequate housing.

*This leads to assessment element 19, 20 and 21.*

- **Right to adequate housing and workplace**

  As is stated in the International Covenant on Economic, Social and Cultural Rights (UNCESCR) every human being has the right to adequate housing (article 11). This right extends to include one's family, as well as to the continued improvement of living conditions. In line with the United Nations Guiding Principles on Business and Human Rights (UNGPs) companies have the responsibility to respect this human right. This means that homes have to be built decently, have to be affordable and that everyone's living rights have to be respected.

  Furthermore, article 7 of the UNCESCR also states that the right to the enjoyment of just and favourable conditions of work should be ensured. This also means that employers must guarantee that working conditions are safe and healthy, including the buildings or structures in which work takes place.

  *This leads to assessment elements 18, 19, 20 and 21.*

- **Sustainability reporting**

  In September 2011, the Global Reporting Initiative published additional guidelines for construction companies and real estate companies. The Construction and Real Estate Sector Supplement (CRESS) contains recommendations for reporting on $CO_2$ emissions, the management and the remediation of polluted soil and the outsourcing of work.[439]

  *This leads to assessment elements 5 and 17.*

- **Procurement and supply chains**

  Companies are often part of long production chains. They can monitor one another and question how they respect local and national legislation and international norms regarding social, economic and environmental issues. The requirements that companies set for their suppliers can be included in contractual agreements. The importance of this also recognised in the OECD Guidelines for Multinational Enterprises since its revision in 2011.

  Also the ISO 26000 guideline recognises the importance of supply chain responsibility, because "the impacts of an organisation's decisions or activities can be greatly affected by its relationships with other organisations." A companies' sphere of influence includes relationships within and beyond an organisation's supply chain.[440]

  The UNGPs include a due diligence process in order to identify, prevent, mitigate and account for how companies address their adverse human rights impacts. The process "should cover adverse human rights impacts that the business enterprise may cause or contribute to through its own activities, or which may be directly linked to its operations, products or services by its business relationships."[441]

  Companies in the housing and real estate sector should have adequate procurement and supply chain management policies regarding compliance with international human rights, labour and environmental standards.

  *This leads to assessment elements 22 and 23.*

- **Mortgage loans and securities**

  Financial institutions can provide mortgage loans to private individuals or small businesses. The subprime mortgage crisis in the United States in 2008 showed how the consequences of over-indebtedness are shared among all stakeholders of financial institutions. The Mortgage Credit Directive of the European Union on credit agreements for consumers relating to residential immovable aims to create a Union-wide mortgage credit market with a high level of consumer protection.[442] It applies to both secured credit and home loans. Member States will have to transpose its provisions into their national law by March 2016. In the Netherlands, the Code of Conduct for Mortgage Loans provides rules which dictate what the responsibilities of financial institutions are to consumers when issuing mortgage loans. [443]

  Financial institutions can offer investment opportunities by issuance of mortgage-backed securities; other financial institutions can then invest in these securities. In both cases, both parties should have sufficient policies for the issuance of, or investments in securities, in terms of transparency and sustainability. This also includes other avenues of participating in the real estate portfolios of other financial institutions.

  Financial institutions can also contribute to mitigating climate change by improving the energy efficiency of their mortgage portfolio. They can offer attractive loans for the finance of energy-saving measures (isolation, high-efficient glass, etc.) and renewable energy installations.

  *This leads to assessment elements 24, 25, 26, 27, 28, 29 and 30.*

### 3.6.3 Types of financing and asset classes

Financial institutions can be involved in various ways in financing the housing and real estate sector. They can:

- Provide general corporate loans to, and invest in the shares and bonds of, construction companies, contractors and their suppliers, project developers and housing corporations. Such companies are generally falling under the NACE sections F. Construction and L. Real Estate Activities;[444]
- Finance specific home construction and real estate projects;
- Manage real estate investment funds for external investors. These funds usually make direct investments in rental properties and office and commercial space for institutional investors, but also invest in publicly traded equities of real estate investment funds and in mortgage-backed securities;
- Invest in real estate investment funds managed by other asset managers;
- Provide mortgage loans to private clients and small entrepreneurs;
- Resell packages of mortgage loans via securitisations or otherwise; and
- invest in securitisations of mortgage loans that are provided by other financiers.

For financial institutions operating in the housing and real estate sector, a solid policy on housing, construction and real estate is of great importance. In 0 the types of financing listed above are related to the various asset classes that financial institutions have on their balance sheet, or have under management for external investors.

**Table 1 Asset classes of financial institutions**

| Asset class | Investment objects |
|---|---|
| Corporate credits | Loans to construction companies |
| | Loans to housing corporations |
| | Loans to project developers |
| Project finance | Loans to real estate projects |
| Investments own account | Real estate objects, e.g. rental properties and office and commercial space |
| | Shares and bonds of construction companies, housing corporations and project developers |
| | Real estate funds |
| Asset management | Shares and bonds of construction companies, housing corporations and project developers |
| | Real estate objects, e.g. rental properties and office and commercial space |
| | Real estate funds managed by other asset managers |
| | Mortgage-backed securities |
| Mortgages | Mortgage loans to private clients and small businesses |
| | Issuance of mortgage-backed securities |

### 3.6.4 Assessment elements

The Fair Finance Guide International (FFGI) has defined a number of elements to assess the policies of financial institutions investing in or lending to real estate. The assessment elements are listed in Table 2. FFGI expects financial institutions to apply these elements to all investments in, and loans to, the real estate sector. The assessment elements do not apply to office buildings owned by the financial institutions for their own operations.

Not all assessment elements are applicable for all asset classes, as specified in 0. In Table 2 the relevance of each asset class for every assessment element is therefore also specified. When an assessment is deemed not relevant, this is indicated with *not applicable (n.a.)*. This means that the FFGI does not expect the financial institution to apply this element when investing in this specific asset class.

In case reference is made to “new real estate”, this refers to buildings in development, in construction or recently completed. The term “new buildings” should not be confused with newly acquired real estate by financial institutions, as this real estate could have been developed some time ago.

In case a financial institution’s real estate portfolio is limited to the Netherlands or the European Union, assessment elements 1, 6, 10, 18 and 19 are considered *not applicable,* as these elements are part of Dutch and EU legislation or not relevant in a Dutch and EU context.

## Table 2 Assessment elements for Housing and Real estate

| Assessment element | Corporate credits | Project finance | Investments own account | Asset management | Mortgages |
|---|---|---|---|---|---|
| 1. Companies respect the ILO's Fundamental Principles and Rights to Work, and the ILO conventions on occupational health & safety and maximum working hours. | yes | yes | yes | yes | n.a. |
| 2. Construction companies only use wood certified according to the criteria of the Forest Stewardship Council (FSC). | yes | yes | yes | yes | n.a. |
| 3. Construction companies use recycled and recyclable materials and recycle materials in case of demolition. | yes | yes | yes | yes | n.a. |
| 4. Construction companies implement the Cement Action Plan of the Cement Sustainability Initiative. | yes | yes | yes | yes | n.a. |
| 5. Large and multinational construction companies publish a sustainability report that is set up in accordance with the GRI G4 Sustainability Reporting Guidelines, including the Construction and Real Estate Sector Disclosure (CRESS). | yes | yes | yes | yes | n.a. |
| 6. Construction companies act responsibly when reconstructing homes by following the guidelines of UNEP SBCI's guidelines on Sustainable Reconstruction in Disaster-Affected Countries. | yes | yes | yes | yes | n.a. |
| 7. Construction companies and housing corporations are expected to take into account the Five Principles of sustainable neighbourhood planning. | yes | yes | yes | yes | n.a. |
| 8. New buildings are designed as such that they are suitable for multiple tenants, or can be easily adapted to suit multiple tenants. | yes | yes | yes | yes | n.a. |
| 9. Owners of real estate have a policy on transformation of vacant buildings in their portfolio. | yes | n.a. | yes | yes | n.a. |
| 10. New buildings and houses are as energy efficient as possible, in the EU-context energy neutral, in line with the EU Energy Performance of Buildings Directive. | yes | yes | yes | yes | n.a. |
| 11. Energy reduction measures and greenhouse reduction targets are part of the multi-year maintenance plans with regard to the real estate property portfolios of the financial institution. | yes | n.a. | yes | yes | n.a. |
| 12. Each year, the energy performance of at least 10% of the total real estate portfolio is enhanced, using the best available and viable technologies regarding energy reduction measures and avoidance of greenhouse gas emissions. | yes | n.a. | yes | yes | n.a. |
| 13. New real estate falls within the top segment of sustainability certification systems. E.g. New real estate at least complies with the "Very Good" requirements of BREEAM International New Construction or comparative targets. | yes | yes | yes | yes | n.a. |
| 14. Redeveloped real estate and renovated houses score within the top 50% of sustainability certification systems. E.g. Renovated real estate at least complies with the "Good" requirements of BREEAM International Refurbishment & Fit-Out or BREEAM In-use or comparative targets. | yes | n.a. | yes | yes | n.a. |

| Assessment element | Corporate credits | Project finance | Investments own account | Asset management | Mortgages |
|---|---|---|---|---|---|
| 15. New buildings and houses that are part of the real estate property portfolios of the financial institution score within the top 10% on energy efficiency for the particular type of building which is minimum label A++ EU Energy Performance Certificate for buildings (EPC ≤ 0.4 residential; EPC ≤ 0.8 utilities; EPC ≤ 1.7 retail). | yes | yes | yes | yes | n.a. |
| 16. Redeveloped real estate and renovated buildings and houses score within the top 10% on energy efficiency for the particular type of building which is minimum label A EU Energy Performance Certificate for buildings. | yes | n.a. | yes | yes | n.a. |
| 17. Real estate funds score at least 50 points in the Global Real Estate Sustainability Benchmark. | n.a. | n.a. | yes | yes | n.a. |
| 18. Real estate developers respect the rights of local communities living in project areas before project development and do not evict and relocate them without free, prior and informed consent. | yes | n.a. | yes | yes | n.a. |
| 19. Real estate developers respect the rights of tenants living in their real estate projects and do not evict and relocate them without free, prior and informed consent. | yes | n.a. | yes | yes | n.a. |
| 20. Real estate owners and managers respect the rights of tenants to participate in decisions regarding renovation and maintenance. | yes | n.a. | yes | yes | n.a. |
| 21. Real estate owners and managers carry out and publish the results of customer satisfaction surveys. | yes | n.a. | yes | yes | n.a. |
| 22. Companies in the housing and real estate sector integrate social, economic and environmental criteria in their procurement and operational policies. | yes | yes | yes | yes | n.a. |
| 23. Companies in the housing and real estate sector include clauses on the compliance with social, economic and environmental criteria in their contracts with subcontractors and suppliers. | yes | yes | yes | yes | n.a. |
| 24. Financial institutions report on the energy efficiency of the houses and buildings financed with mortgages. | n.a. | n.a. | n.a. | n.a. | yes |
| 25. Financial institutions implement a policy to improve the energy efficiency of the houses and buildings financed with mortgages. | n.a. | n.a. | n.a. | n.a. | yes |
| 26. Financial institutions have an ambitious time bound target to improve their mortgage portfolio. | n.a. | n.a. | n.a. | n.a. | yes |
| 27. Financial institutions actively offer mortgage loans and services to clients to enable them to make their property more sustainable. | n.a. | n.a. | n.a. | n.a. | yes |
| 28. Financial institutions apply the Code of Conduct for Mortgage Loans based on the EU Mortgage Credit Directive. | n.a. | n.a. | n.a. | n.a. | yes |
| 29. Financial institutions that issue mortgage-backed securities | n.a. | n.a. | n.a. | n.a. | yes |

| Assessment element | Corporate credits | Project finance | Investments own account | Asset management | Mortgages |
|---|---|---|---|---|---|
| are transparent about the sustainability aspects of the building stock (e.g. energy efficiency). | | | | | |
| 30. Financial institutions only invest in mortgage-backed securities if there is sufficient transparency concerning the sustainability aspects of the building stock (e.g. energy efficiency). | n.a. | n.a. | yes | yes | n.a. |

## 3.7 Manufacturing industry

### 3.7.1 What is at stake?

The manufacturing industry includes all industries that process materials into new products. Therefore, the manufacturing industry is comprised of various industries like the automotive industry, the chemical industry, the plastics industry, the clothing industry, shipbuilding, the electronics industry, the metallurgical industry, the graphic industry and many other industries. The differences between these industrial activities are often large. The chemical industry is for example characterised by high capital and knowledge intensity while the wood and furniture industry is characterised by low capital and knowledge intensity.[445] What these industries generally have in common is that they are characterised by complex chains in which a multitude of suppliers of raw materials, components and semi-finished products play a role.

Globally, a large part of the global work force is working in the manufacturing industry, either for the manufacturers of finished products or for their suppliers. In 2012 about 14% of the work force worked in the manufacturing industry.[446] Therefore, the development of the manufacturing industry in a country or region also plays an important role in creating employment and economic growth. Since the economic crisis of 2008 a 'reshoring'- trend can be seen in Europe and the United States: jobs in production that were outsourced to low wage countries ('offshoring') are now done in developed economies again.[447]

At the same time, the manufacturing industry also has some negative social and environmental aspects.. Globalisation and increased international competition ensure that labour conditions and labour rights are regularly under pressure: to be able to compete and ensure employment, employees have little power to resist. This applies to both wealthier, industrialised countries, as well as to less developed countries.[448]

Some governments create special export zones where the existing labour legislation does not apply, in order to attract manufacturing industry companies. In these zones, companies often pay hardly any tax. In these cases, the added value for the local economy, besides creating poor employment, is virtually nil. Parts are imported; they are assembled and then exported again. So although these zones hardly lead to economic added value, many governments still participate in this process under pressure from international companies that threaten to relocate to another location. There is effectively a *race to the bottom* where countries try to outdo each other by offering the lowest tax rates and the worst labour rights.[449]

In some branches of the manufacturing industry where low skilled labour is used a lot, such as the clothing and shoe industry and the production of electronic components, child labour, extremely long working days, poor health and safety conditions, poor remuneration and the denial of union rights are commonplace.[450] Also, some manufacturing industry branches are highly polluting due to the use of toxic substances in products or production processes. These substances usually end up in the environment sooner rather than later, where the pollution of the soil, water and air threatens flora and fauna as well as human health. Examples are the chlorine that is used in the production of the well-known plastic PVC and the many heavy metals that are used in electronics.[451]

The large, well-known manufacturers of finished products focus more and more on product development and marketing. The rest of the production process is outsourced and, as a result, the main social and environmental problems do not occur directly within these companies themselves. The problems have been moved to earlier steps in the chain, to their suppliers.[452] Two types of suppliers can be distinguished. Firstly, the direct suppliers of semi-finished products and components, of which the factories are often located in export zones or in countries with less strict social and environmental regulations and a less strongly developed supervision and enforcement system. At these types of suppliers, labour issues and problems with air, soil and water pollution around the factory mainly occur.

Even earlier in the production chain we find metals and minerals manufacturers, of oil and gas (for the chemical and plastics industry) and wood, cotton producers and producers of other agricultural products. In these industries labour issues also play a role, but in addition there is also local environmental pollution, deforestation and deterioration of biodiversity as well as land rights conflicts with the local population. Furthermore, the manufacturing industry is a major water user, with expected global increases in demand for water of 400% between 2000 and 2050, leading all other sectors.[453]

Throughout the entire chain there are negative consequences of flexible labour relations as a result of using intermediaries to hire people. Increasingly fewer people work directly for the companies in the chain; employees are increasingly hired by means of agents, labour brokers, temporary employment agencies and subcontractors. As a result of this, employees generally have fewer rights, worse working conditions, less security and worse labour conditions.[454]

The investment policy of financial institutions has to ensure that financial institutions are only involved in investments in companies in the manufacturing industry that take the responsibility to prevent social and environmental problems in their own branches, but also in the branches of their suppliers.[455] When developing policies for this industry, financial institutions can make use of the international standards described below.

### 3.7.2 International standards

Below, the main international standards are described for the manufacturing industry as a whole, and for some individual industries that can be marked as part of the manufacturing industry:

- **Harmful substances**

  The EU Regulation on Registration, Evaluation, Authorisation and Restriction of Chemicals (REACH) protects people's health and protects the environment against the risks of chemicals. In order to comply with the regulation companies must identify and control the risks connected to the chemicals they produce in Europe or which they launch in the European market. They must show how the chemical may be safely used and they must report measures which reduce risks to the users. If the risks cannot be prevented, the authorities may reduce the use of chemicals. Under REACH all the companies in the supply chain of chemicals (producers, importers, users and buyers) are responsible. REACH is based on the precautionary principle, which entails that companies need to be responsible and proactive in avoiding certain potential risks. In relation to chemicals, when the risks involved with the use of a substance cannot be satisfactorily quantified and removed, even if a cause and effect relationship has not been fully proven scientifically, then this substance should not be used. The burden of proof for the safety of a chemical should lie with the company and not with the public. A lack of scientific consensus on the possible harmfulness of a chemical is not a sufficient reason to avoid precaution. This is also the case when a substance is not restricted or regulated by the government. Furthermore, the principle also entails considering alternatives and considering the full impacts of a substance over time.[456]

  OHSAS 18001 is an international standard that provides guidelines for a management system with regard to health and safety risks in the workplace (Occupational Health and Safety). It applies to every type of organisation and it serves to safeguard health and safety of employees and stakeholders outside the organisation, such as contractors' staff and visitors. OHSAS 18001 means that risks are structurally surveyed and evaluated.

  *This leads to assessment elements 1, 2 and 3.*

- **Water use**

  Given the growing challenge of water scarcity, it is vital that companies and financial institutions become aware of their own influences on water related problems. Various initiatives, guidelines and standards have emerged in recent years, to help companies address water risk.

  Initiatives companies could participate in and learn from are:

  - The UN Global Compact's CEO Water Mandate is a public-private initiative designed to assist companies in the development, implementation and disclosure of water sustainability policies and practices.
  - The guidance by the UNEP and CEO Water Mandate on Corporate Water Accounting: An Analysis of Methods and Tools for Measuring Water Use and Its Impacts.
  - The European Water Partnership; and
  - The Water Footprint Network, which also has a standard on assessing a global water footprint.

  There are several guidelines and water 'footprinting' methods as well as voluntary disclosure initiatives for calculating water use, water risk, understanding water issues and creating a sound water strategy, such as:
  - The CDP's Water Program, to calculate and publish corporate water use throughout the supply chain;
  - The GEMI Water Sustainability Tool; and
  - The WBCSD Global Water Tool.

Alternately, the AWS International Water Stewardship Standard is a new standard, soon to be supported by a verification process. It defines a set of water stewardship criteria and indicators for how water should be stewarded at a site and catchment level in an environmentally, socially, and economically beneficial manner.
*This leads to assessment element 4 and 5.*

- **Risk management**

The ISO 14000 standards for an Environmental Management System (including ISO 14001) help companies to reduce negative impacts of their production processes on the environment and to structure their business process in such a way that these comply with existing environmental regulations. ISO 14000 standard provide guidance and criteria for establishing an effective management system. Certification will be done by an independent third party. ISO 14000 is an integrated part of the EU Eco-Management and Audit Scheme (EMAS). However, EMAS makes heavier demands on improving performance, reporting and compliance with the law.

*This leads to assessment element 8.*

- **Labour rights**

Complying with fundamental labour rights is a large challenge for a lot of branches of the manufacturing industry. The main standard in this field is the 1998 ILO Declaration on Fundamental Principles and Rights at Work, in which the ILO established four fundamental principles and rights at work:

- Freedom of association and the right to collective bargaining;[457]
- Banning of all types of forced labour;[458]
- Banning child labour;[459] and
- Banning discrimination (based on ethnicity, gender, and social background) with respect to offering work or specific positions.[460]

Another leading ILO document is the Tripartite Declaration of Principles Concerning Multinational Enterprises and Social Policy. The Tripartite Declaration focuses on the responsibility of companies and specifically on their dealings with labour issues. Besides the reaffirmation of the rights on freedom of association and collective bargaining and the ban on discrimination and forced labour, the agreement calls upon companies to improve working conditions, develop opportunities to improve equal chances and treatment to provide the best possible wages and fringe benefits for employees.

*This leads to assessment elements 9, 10 and 11.*

- **Standards for specific products**

  The Clean Clothes Campaign (CCC) is a coalition of social organisations in 16 European countries that strives for improvement of the working conditions in the global clothing and sports shoes industry. The campaign has developed the CCC Model Code, which companies in this industry can use. The CCC also has published a road map for companies that want to improve the working conditions in their supply chain: preparing a code of conduct for suppliers, implementing the code, organising a credible participation of stakeholders in the initiative, freedom of association and respect of the right to collective bargaining. Following a fire in a clothing factory in Bangladesh the CCC concluded an agreement with a number of large multinational clothing producers in November 2012. The Bangladesh Fire and Building Safety Agreement calls on all the companies to invest in (fire) safety in their factories.

  The Dutch Fair Wear Foundation is a cooperation of Dutch clothing companies and social organisations. The participants are bound to a code of conduct that is based on the ILO Principles and the Universal Declaration of Human Rights. The code of conduct states that the participants are responsible for the working conditions in the factories with which they cooperate. Each participant therefore regularly checks the working conditions in the chain and, if needed, introduces improvement plans. The Fair Wear Foundation ensures independent monitoring of the implementation of the code of conduct by participating companies.

  The Better Cotton Initiative (BCI) is a global multi-stakeholder network of stakeholders from the entire cotton and textile chain. In July 2009, the second edition of the BCI Global Principles, Criteria and Enabling Mechanisms was published, which provides guidelines for the sustainable and fair production of cotton.

  The global production of toys mainly takes place in East Asia in companies that are forced by their clients to produce as cheaply as possible. This leads to poor working conditions, low wages, no recognition of labour unions and other violations of labour rights. The International Council of Toy Industries (ICTI) uses labour guidelines in the toy industry.

  In February 2006, organisations of chemical companies from all over the world jointly presented the Responsible Care Global Charter. In this document, the chemical industry formulates objectives with respect to health, safety, the environment and communication with all stakeholders in their products and processes.

  The Electronic Industry Citizenship Coalition (EICC), a group of companies from the ICT-industry, drafted the Electronic Industry Code of Conduct in October 2005, which was updated in 2012 This code of conduct sets norms for ICT-companies with respect to the environment, labour, health and safety, management systems and business ethics.

  Between August 2006 and November 2012, Greenpeace International published the quarterly Green Electronics Guide. This guide compared leading mobile phone and PC manufacturers on the processing of toxic substances in their products and the processing of their products in the waste phase. Following these publications, a lot of companies have adapted their policy.

  *This leads to assessment element 12 and 13.*

- **Sustainability reporting**

  The Global Reporting Initiative has drafted guidelines on how to write sustainability reports. Besides the general G4 Sustainability Reporting Guidelines it also provides sector guidance for a number of industrial sectors. The Mining and Metals Sector Disclosures includes guidelines on companies active in exploration, mining and primary metal processing (including smelting, recycling and basic fabrication). For small and medium enterprises (SMEs), less elaborate sustainability reporting is required. SMEs can report on the GRI indicators that are relevant to their operations, for example by following the High5! Approach.

  *This leads to assessment elements 14 and 15.*

- **Procurement and supply chains**

  Companies are often part of long production chains. They can monitor one another and question how they respect local and national legislation and international norms regarding social, economic and environmental issues. The requirements that companies set for their suppliers can be included in contractual agreements. The importance of this also recognised in the OECD Guidelines for Multinational Enterprises since its revision in 2011.

  Also the ISO 26000 guideline recognises the importance of supply chain responsibility, because “the impacts of an organization's decisions or activities can be greatly affected by its relationships with other organizations.” A companies’ sphere of influence includes relationships within and beyond an organisation’s supply chain.[461]

  The United Nations Guiding Principles on Business and Human Rights include a due diligence process in order to identify, prevent, mitigate and account for how companies address their adverse human rights impacts. The process “should cover adverse human rights impacts that the business enterprise may cause or contribute to through its own activities, or which may be directly linked to its operations, products or services by its business relationships.”[462]

  The attention to sustainability in the supply chain is growing. According to a study done in 2007 among 120,000 outsourcing companies, 94% of the listed companies and 36% of the non-listed companies establish sustainability requirements for their suppliers.[463] By now various standards are available that help companies in formulating the requirements to suppliers and checking whether they comply with these requirements:

  - In 1997, the US organisation Social Accountability International (SAI) published the Social Accountability 8000 (SA8000) Standard, based on a multi-stakeholder process in which labour unions, human rights organisations, companies and other experts participated. The standard, which was revised in 2008, focuses on labour relations in the supply chains and follows the ILO norms and UN conventions. Based on SA8000, a verification system has been set up that works with independent certification institutions. Companies that work according to this standard have introduces policies and procedures that protect the rights of the employees. This includes clauses with regard to, amongst other topics, child labour, forced labour, health and safety, the freedom of association and negotiation, discrimination, working hours and pay. SA8000 requires a thorough management system that should guarantee consistency with the standard.
  - In November 2004, FTSE, the UK supplier of investment indices published the FTSE4Good Supply Chain Labour Standards Criteria. These criteria are based on the *ILO Tripartite Declaration* and have been developed together with the Ethical Trading Initiative, Fair Labour Association and Social Accountability International.

- In recent years, various international companies have concluded a so-called *International Framework Agreement (IFA)* with an international umbrella union. In an IFA, established agreements can be recorded on labour conditions, working conditions and labour rights for all subsidiaries of the company and its suppliers.
- In July 2008, the Global Reporting Initiative launched the GRI Global Action Network for transparency in the Supply Chain (GANTSCh). The network will help larger and smaller companies in mapping out their supply chain and providing transparency.

*This leads to assessment elements 16 and 17.*

### 3.7.3 Assessment elements

Before financial institutions invest in or finance companies in the manufacturing industry, a financial institution has to ensure whether the company, as well as its suppliers, meets the relevant international guidelines and agreements in the social and environmental fields. This means that in the investment policy of financial institutions on the manufacturing industry, clear norms have to be drafted.

The following elements are crucial for a policy regarding the companies a financial institution invests in or finances:

1. Companies reduce their direct and indirect greenhouse gas emissions.
2. Companies reduce their direct and indirect emissions of harmful substances, such as sulphur dioxide and ammonia.
3. Companies restrict the use of chemicals of which it is suspected in scientific literature that they are harmful to human health and, if necessary, only in a responsible way (precautionary principle).
4. Companies use as little water as possible.
5. Companies prevent water pollution.
6. Companies conduct water scarcity impact assessments and prevent negative impacts in water scarce regions.
7. Companies do not start new operations in areas where water scarcity is pre-existing and operations would compete with the needs of communities.
8. Companies apply an Environment and Social Risk Management System.
9. Companies respect the ILO Declaration on Fundamental Principles and Rights at Work.
10. Companies pay a living wage to their employees.
11. Companies work towards the systematic improvement of safety and health of employees and develop a preventative culture in the field of health and safety.
12. Companies in the manufacturing industry work with relevant standards and initiatives for certain products (mentioned in section 3.7.2).
13. Companies in the manufacturing industry are certified according to the criteria of the certification schemes for certain products (mentioned in section 3.7.2).
14. Companies publish a sustainability report that may contain (a number of) Standard Disclosures from the GRI G4 Sustainability Reporting Guidelines.
15. Large enterprises and multinational enterprises publish a sustainability report that is set up in accordance with the GRI G4 Sustainability Reporting Guidelines.
16. Companies integrate social, economic and environmental criteria in their procurement and operational policies.[xviii]
17. Companies include clauses on the compliance with social, economic and environmental criteria in their contracts with subcontractors and suppliers.

xviii If the financial institution has no specific sector policies or does not mention this in its sector policies, but does mention this in cross-cutting policies for at least three themes, the financial institution is deemed to comply with this element.

## 3.8 Mining

### 3.8.1 What is at stake?

Mining and ore refining are highly polluting activities that affect soil and water quality. A lot of extractive industry activities take place in open quarries, due to which the natural habitat of plants and animals is destroyed in large areas. In addition, mining companies use huge amounts of water to separate the minerals in excavated mud or to dump acidic, toxic and even radioactive waste. Rivers that supply people, animals and forests with water are seriously polluted, as are the seas into which these rivers flow. In addition, pollution of waterways leads to erosion. A lot of mines are located in hilly or mountainous areas and when forest vegetation disappears - mainly after rainfall - the soil can start to slide, ending up in local waterways. Erosion can even lead to landslides and fatal floods.[464]

The consequences of the extractive industry have an effect long after the extractive industry's activities have been finished. Generally, repair work is insufficient to restore nature in the extractive industry areas. Long-term problems - such as the leaking of acid from the mines - can pollute the waterways in the vicinity for decades or even centuries.[465] Furthermore, mining ore and also ore refining - even with the use of modern technologies - causes air pollution over a large area.[466]

Both the near environment and the economic, social and cultural rights of local communities are affected by mining. A common problem in the extractive industry is that mining companies do not respect the land rights of the local inhabitants. The companies deprive these communities of large areas of land and forest of which they depend upon for their food and livelihood.[467] In addition, the pollution of the mines can lead to an accumulation of heavy metals in the soil, the water and the air in the vicinity. These metals cause serious health problems if the drinking water supplies of local communities are polluted or destroyed, or if the air is inhaled. Also, the heavy metals harm the health of the local population indirectly, because the crops and animals they need to survive have absorbed the heavy metals.[468]

In a lot of mining companies the work is very dangerous, with poor working conditions, many accidents and poor safety conditions. Moreover, fundamental labour rights are often not respected and child labour also occurs frequently.[469]

Finally, the extractive industry disturbs the macro-economic development in a lot of countries; this is also referred to as the resource curse.[470] In developing countries, with no stable political or legal system, the exploitation of metals and minerals from the soil often leads to corruption, irreducible revenues, bad management of the supplies and the unequal division of the revenues within the local communities. The costs related to protecting the environment and to ensuring social cohesion will be borne by the population, or in other words: by those that have made little or nothing from the exploitation. As a result, the extractive industry basically leaves a lot of countries even poorer than prior to the development of the industry. The African Development Bank has calculated that African countries miss out on USD 50-60 billion due to the resource curse. Moreover, the industry regularly leaves countries with conflicts between local population groups, the mining companies and the government.[471]

Some mining companies operate in developing countries yet the related subsidiaries are located in tax havens in order to pay as little tax as possible. According to Publish What You Pay Norway, after the US state Delaware, the Netherlands is the favourite hosting country for mining companies. The ten largest oil companies and mining companies globally that own natural resources in developing countries have 365 subsidiaries in the Netherlands. However, under Dutch legislation it is impossible to investigate the fiscal and financial data of these subsidiaries. Therefore, it proved to be very difficult to determine how much revenue companies make from the activities in these countries and how much tax the governments lose.[472]

Some minerals extracted by the mining industry are sourced from areas in which conflict is taking place and the mining and trade of these minerals is involved in the fuelling and financing of this conflict, leading to serious human rights abuses. Important areas to consider are the Democratic Republic of Congo (DCR), Afghanistan, Colombia and Zimbabwe.[473]

Besides large scale mining companies, artisanal, small-scale mining industries are also active in a lot of countries. According to CASM (Consultative Group for Artisanal and Small-Scale Mining, established by the World Bank) this concerns thirteen to twenty million people in about fifty developing countries. Globally, over one hundred million people fully or partially depend on the industry for their livelihood. These people often belong to the most vulnerable population groups. But small-scale extractive industry activities can also cause environmental problems, enhance material poverty and harm human health. This is because these activities also take place in fragile ecosystems with large degrees of cultural and biological diversity.[474]

The Indigenous Rights Risk Report for the Extractive Industry (U.S) by First Peoples Worldwide, published in October 2013, shows that a lot of mining (92%) in developing countries involves a lot of risks for shareholders. Especially when it concerns mining in or near areas where indigenous peoples live. John Ruggie (the main author of the UN Guiding Principles on Business and Human Rights) calculated that extractive companies lose USD 20 to USD 30 million on average every week when indigenous peoples rise in revolt. Ruggie also points out that the extractive industry estimates that asset managers will spend between five and ten percent of their time on 'community engagement issues'. But there are also examples of 50 or even 80%.[475]

The extractive industry consists of companies that extract, transport, purify and store minerals. The products are then processed and used in several other industries on a large scale, such as the electronics industry, the construction industry and the automotive industry. These industries strongly depend on the extractive industry and to a certain extent are also involved in the negative effects of the mines and refineries on the environment and local communities.

In order to contribute to a more sustainable and socially just world, the extractive industry will have to drastically change course. The policy of financial institutions has to be aimed at only engaging in financial relations with mining companies that are willing to do so. When developing policies for this industry, financial institutions can make use of the international standards described in the following section.

### 3.8.2 International standards

Various international initiatives are involved in the risks that extractive industry pose for human beings and the environment; globally there is increasingly more animo to apply standards to this industry. In addition, there are some international conventions and multi-stakeholder processes that set standards for specific extractive industry activities, such as those depicted below.

- **Areas of high biodiversity and protected areas**

  Extractive industry activities may not take place in areas listed in the categories I to IV of the World Conservation Union, or included in the UNESCO World Heritage Convention or in the Ramsar Convention on Wetlands. Furthermore, extractive industry projects in areas that fall under the following conventions and initiatives are to be expressly avoided: forests identified with the High Carbon Stock Approach, Marine Protected Areas, High Conservation Value areas and IUCN protected areas.

  Many of these areas are also included in the analyses for investments by International Finance Corporation's (IFC) Performance Standard 6 concerning Biodiversity Conservation and Sustainable Management of Living Natural Resources. It determines how companies should operate in order to avoid negative consequences on areas of high biodiversity value, including impact on natural habitats as well as endangered and endemic species. The requirements in the standard have been guided by the Convention on Biological Diversity.

  *This leads to assessment elements 1, 2 and 3.*

- **Crisis response and crisis prevention**

  As part of the Awareness and Preparedness for Emergencies at a Local Level (APELL) programme in 2001, which provides assistance to governments, companies, aid organisations and communities in preparing for any incidents and in response to environmental disasters in the extractive industry, the United Nations Environment Program (UNEP) has set up a multi-stakeholder initiative involved in the sustainability of the extractive industry. The initiative has not yet lead to new standards, but a report states that new standards are required and that financial service providers should include these standards in their investment policies.

  *This leads to assessment elements* 4 *and* 5.

- **Waste management**

  Many environmental problems in the extractive industry concern dealing with extractive waste. The existing standards and guidelines with regard to waste management are:

  - The Convention on the Prevention of Marine Pollution by Dumping of Wastes and other Matter (1972), of the United Nations International Maritime Organization (IMO). The convention prohibits the direct dumping of mercury and mercury compounds into the sea and makes special permits a requirement to dump cyanide and other heavy metals.
  - The World Bank Extractives Industries Review (EIR, 2003) advises companies to avoid waste dumping in the sea and in rivers and to look for safer alternatives for the use of cyanide and mercury. The most recent update for this advice is from 2004.
  - The Mining, Minerals and Sustainable Development (MMSD) project of the International Institute for Environment and Development, which ran from 2000 to 2002, supports a ban on the dumping of extractive waste in rivers. Legislative authorities in the United States and Canada have now prohibited dumping waste directly into rivers. In 2012 an update was published which discusses the industry's progress.
  - The Directive on the Management of waste from the extractive industries, published by the European Commission in 2006, requests that European Union member states ensure that extractive waste is managed without endangering human health or the environment, especially water, air, soil, flora and fauna. The member states also need to take the necessary precautions to prohibit the uncontrolled abandonment, dumping and disposal of extractive waste.

*This leads to assessment elements* 6 *and* 7*.*

- **Water use**

  Given the growing challenge of water scarcity, it is vital that companies and financial institutions become aware of their own influences on water related problems. Various initiatives, guidelines and standards have emerged in recent years, to help companies address water risk.

  Initiatives companies could participate in and learn from are:

  - The UN Global Compact's CEO Water Mandate is a public-private initiative designed to assist companies in the development, implementation and disclosure of water sustainability policies and practices.
  - The guidance by the UNEP and CEO Water Mandate on Corporate Water Accounting: An Analysis of Methods and Tools for Measuring Water Use and Its Impacts.
  - The European Water Partnership; and
  - The Water Footprint Network, which also has a standard on assessing a global water footprint.

  There are several guidelines and water 'footprinting' methods as well as voluntary disclosure initiatives for calculating water use, water risk, understanding water issues and creating a sound water strategy, such as:

  - The CDP's Water Program, to calculate and publish corporate water use throughout the supply chain;
  - The GEMI Water Sustainability Tool; and
  - The WBCSD Global Water Tool.

  Alternately, the AWS International Water Stewardship Standard is a new standard, soon to be supported by a verification process. It defines a set of water stewardship criteria and indicators for how water should be stewarded at a site and catchment level in an environmentally, socially, and economically beneficial manner.

  *This leads to assessment elements 8 and 9.*

- **Closing depleted mines**

  The condition in which exhausted mines are left behind has large consequences for the population and the ecosystems in the vicinity. Negative environmental and health effects can have an impact for years - perhaps even centuries. The Mining, Minerals and Sustainable Development (MMSD) project asks companies to take the environment and health effects after closing mines into consideration in the plans for the development of the mine and in the assessment of the effects on local communities. This means the future destination of the mine, the provisions to be made and the responsibilities of the mining company need to be taken into account.

  The United States is a good example. Here, government rules on the closure of mines require financial guarantees for the sanitation, remediation and restoration of the natural environment.

  *This leads to assessment elements 10 and 11.*

- **Small scale and artisanal extractive industry**

  Small scale and artisanal extractive industry projects - provided they are well managed - can enhance sustainable economic and social development on a local level. The Alliance for Responsible Mining (ARM) is an independent multi-stakeholder initiative that aims to enhance social justice and wellbeing in the small scale extractive industry by improving social, environmental and working conditions, solid management of the mines and conducting repair work for the ecosystem. In 2009, ARM presented the final edition of the Standard Zero for Fair Trade Artisanal Gold and Associated Silver and Platinum, which sets social and environmental standards for the small-scale extractive industry. In addition, the Fairtrade Labelling Organizations International (FLO) and ARM have jointly developed the Fairtrade and Fairmined Standard for Gold. Since 2013 only the ARM has worked on an update of the Fairmined Standard for Gold. In November 2013 the ARM has started cooperation with the Swiss Institute for Market Ecology in order to develop an independent certification and auditing system for the Fairmined Standard.

  While investment in mining activities may not include direct investment in artisanal or small-scale mining, investment in industrial mining operations does still have consequences for small-scale and artisanal mining. As the 9th principle of the ICMM states, companies should contribute to the social, economic and institutional development of the communities in which they operate. This includes the communities of artisanal and small-scale miners, which often live and work around or near large-scale mines. Large-scale mining operations already engage with artisanal miners and their dependents through community development programs, but certain issues, such as security and human rights, still require attention. In 2010 the ICMM published the report Working together: How large-scale mining can engage with artisanal and small-scale miners, discussing a sound engagement approach with small-scale miners, as key stakeholders for large-scale mining companies.

  *This leads to assessment element 12.*

- **Labour rights**

  Besides respecting human rights, it is of great importance that mining companies adhere to the United Nations International Labour Organisation's main codes of conduct, the ILO. These are the 1998 ILO Declaration on Fundamental Principles and Rights at Work and the Tripartite Declaration of Principles Concerning Multinational Enterprises and Social Policy. In addition, specifically for the extractive industry, the 1995 Safety and Health in Mines Convention should be taken into account. The rights of women in the extractive industry are recognised in the Iroco Declaration.

  *This leads to assessment element 13.*

- **Land rights conflicts and forced evictions**

  The right to food, water, housing and work are included in the International Covenant on Economic, Social and Cultural Rights (ICESCR).[476] These rights are connected to the non-defined right to land.

Regarding adequate housing, governments have the obligation to guarantee security of tenure, which includes protection against forced eviction.[477] As noted by the UN Special Rapporteur on Adequate Housing: "Involuntary resettlement amounts to a forced eviction when it occurs without the provision of, and access to, appropriate forms of legal or other protection."[478] The protection measures that should be applied to all evictions are articulated in the Basic Principles and Guidelines on Development-based Evictions (2007), developed by the UN Special Rapporteur on Adequate Housing.[479] They reflect existing standards and jurisprudence on this issue, including detailed guidance on steps that should be taken prior to, during and following evictions in order to ensure compliance with relevant principles of international human rights law.

The 11 core principles of the United Nations Special Rapporteur on the right to food, include the notion that any shifts in land use can only take place with the free, prior and informed consent of the local communities concerned. This is particularly important for indigenous communities, in view of the discrimination and marginalization they have been historically subjected to.

In May 2011, the Tirana Declaration was adopted by over 150 representatives of civil society organisations, social movements, grassroots organizations, international agencies, and governments. According to The Declaration land acquisitions or concessions should, amongst others, be based on free, prior and informed consent of the affected land-users.

In 2004, Oxfam Australia developed a code of conduct for mining companies on how to deal with the rights of nearby residents. In this code of conduct, five basic rights are defined:

- The right to be heard;
- The right to livelihood, including the rights on suitable re-settlement, compensation, employment and a clean environment;
- The right to basic provisions, such as clean water, education, and health care;
- The right to life and safety; and
- The right to equal treatment.

In the code of conduct, these rights are further elaborated through concrete steps that mining companies would have to take.

In 2013 the International Council on Mining and Metals (ICMM) issued guidelines for its member companies. The Indigenous Peoples and Mining Position Statement deals with the obligations of extractive companies with regard to the indigenous peoples. The guidelines should replace a document from 2008. The most important change is that companies are expected to commit to work to obtain the consent (FPIC) of indigenous peoples for new projects located on lands traditionally owned by or under customary use of indigenous peoples.

*This leads to assessment elements 14 and 15.*

- **Security and law enforcement**

Companies can get involved in violations of human rights when (private or public) company security officers use violence against nearby residents of the company. This issue is dealt with in the UN Code of Conduct for Law Enforcement Officials and the UN Basic Principles on the Use of Force and Firearms by Law Enforcement Officials. Based on this code of conduct and principles, in a multi-stakeholder process the Voluntary Principles on Security and Human Rights have been developed that set guidelines for companies for their security methods.

*This leads to assessment element 16.*

- **Access to remedy**

Mining companies need to respect the rights of local communities affected by mining. The responsibility to respect requires that companies avoid causing or contributing to adverse human rights impacts through their own activities and seek to prevent or mitigate impacts that are directly linked to their operations by their business relationships. According to the United Nations Guiding Principles on Business and Human Rights (UNGPs), if a company identifies a risk or is contributing to an adverse impact, it should cease or prevent its contribution and to mitigate any remaining impacts to the greatest extent possible. Finally, the enterprise should provide for or cooperate in their remediation through legitimate processes. They should establish or participate in effective operational-level grievance mechanisms for individuals and communities who may be adversely impacted.[480]

Since 2000, Oxfam Australia has acted as an ombudsman for the extractive industry. During this period of time, numerous complaints of violations of human rights, environmental pollution and the unequal division of extractive industry revenues have been dealt with. Based on the experience gained, a grievance mechanism for the extractive industry was proposed by Oxfam Australia in 2009 that can deal with grievances, give advice and provide the compliance with standards and recommendations for the grievance mechanism. For a grievance mechanism for the extractive industry to work properly, six conditions have to be met: clear standards, independency, transparent financing, possibilities to force compliance, access to information and accountability. For the time being there is no grievance mechanism that complies with these conditions.

*This leads to assessment elements 17.*

- **Transparency of financial flows**

In the Extractive Industries Transparency Initiative (EITI) a coalition of governments, companies, social organisations and investors have drafted criteria for governments of countries where extractive industry activities take place. The governments are expected to fully publish all revenues they receive from these activities.

The Publish What You Pay coalition, in which more than over 300 social organisations collaborate, advocates that the mining companies themselves also make their payments to governments publicly known. This means that companies have to report on their tax payments in the countries where they operate. They also have to report on royalties, payments for concessions and such. And important contracts and agreements between governments and mining companies and all bank loans related to the exploitation of raw materials should be made public.

The Global Reporting Initiative has drafted the G4 Sustainability Reporting Guidelines on how to write sustainability reports. These guidelines state that organisations should report on the payments they make to governments (EC1) and on the amounts companies receive from governments (EC4). With respect to EC1, in the Mining and Metals Sector Disclosures (MMSD), it has been added that mining companies have to report the payments to governments for each country in which they operate.[481]

In mid-2010, in the United States the Dodd-Frank Act (*Dodd-Frank Wall Street Reform and Consumer Protection Act)* came into force (see also section on conflict minerals). Section 1504 concerns reporting requirements payments to government institutions in relation to the mining of oil, gas and minerals.[482]

In June 2013, the EU adopted Directive 2013/34/EU which obliges big European companies - both listed and non-listed companies - active in the extractive industries and in the logging of primary forests to publicly report on their payments to governments, broken down per country.

The EU also supports the use of *due diligence* processes in the mining sector.[483] In doing so, the EU partly takes over the Dodd Frank Act, but it does make an exception for conflict minerals. Voting on the proposed regulation took place in 2015. The European Parliament voted to overturn the Commission's proposal and requested mandatory compliance for "all Union importers" sourcing in conflict areas. As of December 2015, the Parliament is seeking agreement with the EU.[484]

*This leads to assessment elements 18, 19 and 20.*

- **Good governance**

In order to minimise the negative consequences of the *resource curse*, it is important that the development of the extractive industry is combined with the development of capable and reliable governance. The World Bank Extractive Industries Review (EIR) advises against stimulating private investments in the extractive industry in countries where governance is ineffective. It also states that the quality of governance has to meet explicit conditions before an extractive industry project can be financed by the World Bank.

The UNGPs points to heightened risks of involvement in gross human rights abuses in conflict-affected areas. A company should manage its own impact in order to prevent involvement in human rights violations.

The OECD Risk Awareness Tool for Multinational Enterprises in Weak Governance Zones could be helpful detecting areas were strong governance is needed to avoid human rights abuses or to refrain from doing business.

*This leads to assessment element 21.*

- **Conflict minerals and diamonds**

The problem of proceeds from mineral mining fuelling conflict and civil war has been well-documented for many years, particularly in the Democratic Republic of Congo (DRC) but also in parts of Afghanistan, Colombia, Zimbabwe and elsewhere. Minerals which risk fuelling conflict include gold, coltan (or tantalum), tin (or cassiterite) and wolframite (or tungsten). These resources can enter global supply chains and end up in mobile phones, laptops, jewellery and other products. It is important to note that this includes blood diamonds or conflict diamonds and minerals sourced from conflict zones outside the DRC.

Significant legislation includes Section 1502 of the Dodd Frank Act (passed in 2010), which requires US-listed companies to carry out due diligence on tantalum, tin, gold or tungsten sourced from DRC and neighbouring countries. It also concerns reporting requirements on the use of conflict raw materials from the Democratic Republic of Congo (DRC) and neighbouring countries. Companies that are listed on the New York Stock Exchange and use minerals from this region have to provide insight into the financial flows and research of whether they contribute to the financing of armed groups.[485]

Conflict minerals regulation is being discussed in Europe, and MEPs voted for stronger conflict minerals regulation in May 2015. The discussion on the details of the final regulation are ongoing with the EU member states.[486]

*This leads to assessment element 22.*

- **Unacceptable mining practices**

As almost all mined uranium is used in electricity production, in nuclear power stations (discussed in section 3.10), this can be considered a strategic service to the nuclear power sector. The World Nuclear Association claims that in most respects the environmental impacts of an uranium mine are the same as those of other metal mines, although civil society organizations such as Greenpeace have identified levels of radioactive materials in the air, water and soil above internationally accepted limits around some uranium mines. Many other mined materials are also radioactive. For example, iron contains radioactive isotopes and is included in some lists of radioactive materials. Mined radioactive elements are also used in medical equipment and household items including smoke detectors. Rare earths with radioactive isotopes are used in wind turbines and electric cars. For this reason, the assessment element is limited to uranium mining, rather than to all mining of radioactive materials.

Taking into account the huge impact of coal mining on the environment and local communities, especially extreme mining such as mountain top removal mining, and its contribution to climate change once the coal is burned, these activities are considered unacceptable by the Fair Finance Guide network as well. [487]

*This leads to assessment element 23, 24, 25, 26 and 27.*

- **Standards for a sustainable extractive industry**

Framework for Responsible Mining - drafted by the WWF - provides a clear analysis of environmental, social and governance problems that should be included in its sector policy for the extractive industry.

The Sustainable Development Framework of the International Council on Minerals & Metals (ICMM) is based on the Mining, Minerals and Sustainable Development (MMSD) project. The Framework comprises of 10 principles for sustainable development in the extractive industry, it obliges the participants of ICMM to report according to GRI, including the Mining and Metals Sector Disclosure, and it requires verification of this reporting. Also, a grievance mechanism has been set up for dealing with grievances of ICMM participants.[488]

In February 2015, the mining industry organization ICMM released a best practice guidance on water management: “International Council on Mining and Metals (ICMM) member companies have come to understand that even the most water-efficient operations that stringently manage water discharges can still be subject to significant water risks manifesting outside the operational fence line at the catchment level”. The guidance calls for wide stakeholder engagement and expects companies to consider risks outside its own operations. The guidance accompanies ICMM's 2014 Water stewardship framework.

For some minerals there are specific standards, or they are being developed, including:

- End 2010, the OECD has written recommendations on respecting human rights and avoiding involvement in conflicts in extractive industry areas. The OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas also contains specific guidelines for tin, tantalum, and tungsten.

- The involvement of the diamond industry in armed conflicts has led to the Kimberley Process Certification Scheme. The system forces governments to certify diamonds that are not being used for financing conflict groups. The certification process has proven to be a useful first step to make conflict diamonds recognisable, but it still lacks an independent supervisor.
- The Council for Responsible Jewellery Practices (CRJP) is also working on a certification scheme similar to the Kimberley Process. The council consists of more than 450 companies operating in the product chains of gold, diamonds, jewelry and watches. In November 2013, the CRJP published the third edition of Principles and Code of Practice, together with certification manuals and assessment guidelines. New in 2013 is: all participating companies are expected to produce a human rights report and they must (in relevant cases) take into account the Free and Prior Informed Consent and the extraction of raw materials in conflict areas.
- The Roundtable of Sustainable Platinum Group Metals (PGM) mainly tries to reach agreement on strategic questions within the industry. These questions have to be based on developing concrete actions for sustainable production of PGM, to which all stakeholders agree.
- The gold industry has developed various initiatives:
  - the International Management Code for the use of Cyanide, a voluntary agreement on reducing the use of cyanide, on improving safety in transport and on taking measures that guarantee the miners health and safety. The code also contains plans for crisis management, but lacks guidelines for waste processing.
  - The World Gold Council has developed the Conflict-Free Gold standard. Voluntary participation involves submitting to an audit, of which the results are made public, to assess whether gold has been responsibly extracted.
  - Fairtrade Gold and Precious Metals is a certification scheme for responsibly sourced gold and precious metals from artisanal and small-scale sources that comply with social, environmental, labour and traceability requirements.
  - Another option is Fairmined Gold, a third party assurance scheme developed by the ARM.
  - The Initiative for Responsible Mining Assurance (IRMA) Standard for Responsible Mining, which outlines requirements based on business integrity and social and environmental criteria.
  - The International Conference on the Great Lakes Region (ICGLR) Regional Certification Mechanism has set standards for traceability and certification of minerals in the conflict-prone Great Lakes area.
  - The London Bullion Market Association (LBMA) Responsible Gold Guidance is mandatory for all LBMA accredited refiners and ensures that all gold feed stock and all gold produced by refiners is conflict-free.

Many of these initiatives are still in their infancy and haven't yet developed specific certification schemes that financial institutions can take over literally in their investment policy. Financial institutions have been advised to closely follow the developments of these initiatives and/or actively participate in them.

*This leads to assessment element 28 and 29.*

- **Sustainability reporting**

  The Global Reporting Initiative has drafted guidelines on how to write sustainability reports. Besides the general G4 Sustainability Reporting Guidelines it also provides sector guidance for a number of industrial sectors. The Mining and Metals Sector Disclosures includes guidelines on companies active in exploration, mining and primary metal processing (including smelting, recycling and basic fabrication). For small and medium enterprises (SMEs), less elaborate sustainability reporting is required. SMEs can report on the GRI indicators that are relevant to their operations, for example by following the High5! Approach.

  *This leads to assessment elements 30 and 31.*

- **Procurement and supply chains**

  Companies are often part of long production chains. They can monitor one another and question how they respect local and national legislation and international norms regarding social, economic and environmental issues. The requirements that companies set for their suppliers can be included in contractual agreements. The importance of this also recognised in the OECD Guidelines for Multinational Enterprises since its revision in 2011.

  Also the ISO 26000 guideline recognises the importance of supply chain responsibility, because “the impacts of an organization's decisions or activities can be greatly affected by its relationships with other organizations.” A companys sphere of influence includes relationships within and beyond an organisation’s supply chain.[489]

  The UNGPs include a due diligence process in order to identify, prevent, mitigate and account for how companies address their adverse human rights impacts. The process “should cover adverse humanrights impacts that the business enterprise may cause or contribute to through its own activities, or which may be directly linked to its operations, products or services by its business relationships.”[490]

  *This leads to assessment elements 32 and 33.*

### 3.8.3 Assessment elements

When financial institutions invest in or finance mining companies, they have to be aware of whether the company complies with the relevant international guidelines and agreements on the social and environment fields. This means that in the investment policy of financial institutions, clear norms need to be drafted.

The following elements are crucial for a policy regarding the companies a financial institution invests in or finances:

1. Companies prevent negative impact on protected areas that fall under the categories I-IV of the International Union for Conservation of Nature.
2. Companies prevent negative impact on UNESCO World Heritage sites.
3. Companies prevent negative impact on protected areas that fall under the Ramsar Convention on Wetlands.
4. Companies mitigate the chance of accidents by making use of the best available techniques and have a solid road map for crisis situations (a ‘contingency plan’).
5. Companies do not operate in locations where the consequences of an accident for the environment are unmanageable.
6. Companies reduce extractive waste and manage and process this in a responsible way.
7. Riverine tailings disposal and sub-marine tailings disposal is unacceptable.

8. Companies conduct water scarcity impact assessments and prevent negative impacts in water scarce regions.
9. Companies do not start new operations in areas where water scarcity is pre-existing and operations would compete with the needs of communities.
10. Companies include the environmental and health effects of a mine after its closure in plans for the development of new mines.
11. Companies ensure the complete recovery of ecosystems after commercial activities have been completed, for all extractive industry projects (i.e. this is included as an activity in the planning and the budget of the project).
12. Companies enhance small scale and artisanal mining that improves sustainable economic and social development on a local level.
13. Companies respect the ILO Declaration on Fundamental Principles and Rights at work.
14. Companies prevent conflicts over land rights and acquire natural resources only by engaging in serious consultation with local communities and obtaining free, prior and informed consent (FPIC) when it concerns indigenous peoples.
15. Companies prevent conflicts over land rights and acquire natural resources only with free, prior and informed consent (FPIC) of the land users involved.
16. Companies follow the Voluntary Principles on Security and Human Rights for the security of their employees and company premises.
17. Companies have processes to enable the *remediation* of any adverse human rights impact which they cause or to which they contribute.
18. Companies pay the taxes owed in each country where they operate.
19. For each country in which companies operate, they report country-by-country on their revenues, profit, FTEs, subsidies received from governments and payments to governments (e.g. withholding taxes, payments for concessions and company tax).
20. Offering, promising, giving and requiring, either directly nor indirectly, bribes or other undue advantages in order to acquire or to maintain assignments or other undue advantages, is unacceptable.
21. Companies only operate in weak governance zone or conflict-affected areas if they are able to demonstrate that they are not causing or contributing to human rights abuses.
22. Mining and trading in conflict minerals is unacceptable.
23. Uranium mining is unacceptable.
24. Mountaintop removal mining is unacceptable.
25. Establishing new coal mines is unacceptable.
26. Thermal coal mining is unacceptable.
27. Metallurgical coal mining is unacceptable.
28. Companies work with relevant standards and initiatives for certain minerals (mentioned in section 3.8.2).
29. Companies are certified according to the criteria of certification schemes for certain minerals (mentioned in section 3.8.2).
30. Companies publish a sustainability report that may contain (a number of) the Standard Disclosures from the GRI G4 Sustainability Reporting Guidelines.
31. Large enterprises and multinational enterprises publish a sustainability report that is set up in accordance with the GRI G4 Sustainability Reporting Guidelines, including the Mining and Metals Sector Disclosure (MMSD).
32. Companies integrate social, economic and environmental criteria in their procurement and operational policies.[xix]
33. Companies include clauses on the compliance with social, economic and environmental criteria in their contracts with subcontractors and suppliers.

xix If the financial institution has no specific sector policies or does not mention this in its sector policies, but does mention this in cross-cutting policies for at least three themes, the financial institution is deemed to comply with this element.

## 3.9 Oil and gas

### 3.9.1 What is at stake?

Several processes within the oil and gas industry may harm the environment. Drilling platforms, oil and gas production facilities, flaring plants, and refineries pollute the land, the air and the water. The urge to fill reserves, leads to oil companies penetrating deeper and deeper into ecologically vulnerable regions, from the Amazon to the Polar Regions. Cracks in pipelines caused by earthquakes, other natural causes and sabotage can lead to soil and water pollution and even to fatal explosions and fires. Moreover, oil spilled from tankers that were involved in accidents has polluted many marine areas and coastlines.[491]

Also, the social consequences of the oil and gas industry can be extremely detrimental, affecting the economic, social and cultural rights of local communities. Pollution and contagious diseases cause harm to the health, food safety and the culture of indigenous (sometimes isolated) population groups. Often, oil and gas companies take the land of local communities and expropriate them from their source of food or revenues. Also, due to pollution, nearby residents can lose their source of income and food supply to the activities of oil and gas companies. Moreover, the mining and transport of oil and gas have regularly contributed to the emergence of armed conflicts, the coming to power of, and remaining in power of, oppressive regimes and the violation of human rights. Especially in situations where companies cooperated with the army or local militias for the security of their operations, great humanitarian harm has occurred.[492]

As with the mining industry, the oil and gas industry often disturbs the macro-economic development of countries. The term *resource curse* is used for the development of corruption, irreducible revenues, bad management of oil supplies and an unequal division of the revenue to the population, in countries that are rich in natural raw materials.[493] Mainly in developing countries where there is no stable political or legal system, the resource curse is a well-known phenomenon. In these countries conflicts regularly arise between the local population, the oil companies and the government.[494] In such countries, companies ignore both the local legislation as well as internationally accepted highest standards for safe business operations, while operating to the letter of the law in industrialised countries where the highest standards are laid down by law. This double standard was clearly shown in a 'Friends of the Earth' report for the business operations of Shell in Nigeria.[495]

Some oil and gas companies operate in developing countries but the related subsidiaries are located in tax havens to pay as little tax as possible. According to Publish What You Pay Norway, after the US state Delaware, the Netherlands is the favourite hosting country for oil companies. The ten largest oil companies and mining companies globally that own natural resources in developing countries have 365 subsidiaries in the Netherlands. However, under Dutch legislation it is impossible to investigate the fiscal and financial data of these subsidiaries. Therefore, it proved to be very difficult to determine how much revenue companies make from the activities in these countries and how much tax the governments lose.[496]

A relatively new form of extracting gas is drilling for shale gas. This is a controversial way of gas extraction and there is a heavy debate on the pros and cons. The risks for people and environment are summarised by Friends of the Earth Netherlands. Polluting water sources with methane and chemicals, the enormous use of clean water, the infringement on landscape and nature due to many drilling sites, bigger chances of accidents with drilling pits and transport, earthquakes caused by fracking, the impact of shale gas and coal gas on climate change, the small economic effects of shale gas and coal gas. A study done by engineering agencies, issued by the European Commission, endorsed these risks.[497]

Furthermore, the Associaton for drinking water companies in the Netherlands (Vewin) has expressed concern about the risks of shale gas extraction: (test) drilling can pollute the groundwater. According to Vewin, Dutch regulations are not sufficient to exclude the risks of groundwater pollution.[498] In December 2014 the Dutch parliament voted against shale gas extraction and artic drilling.[499] Other countries, such as Scotland, South Africa, France and Wales, as well as several states and cities in Canada and the Unites States have also chosen to ban shale gas fracking.[500] The United States recently banned oil and gas drilling in large parts of the Arctic Ocean.[501]

The oil and gas industry plays an important role in global climate change. Global climate change is largely caused by the combustion of fossil fuels supplied by companies in the oil and gas industry. In a world where sustainable energy sources are becoming more important, there is less and less room for the oil and gas industry. Therefore, the largest challenge for this industry is to use its knowledge of energy markets and technologies to develop a supply of clean energy. In preparation for this, oil and gas companies have to minimise the risks of oil and gas production, transport and processing throughout the entire chain in the fields of environment, safety, health and biodiversity.

The investment policy of financial institutions has to ensure that financial institutions are only involved with investments in companies in the oil and gas industry that meets these objectives. When developing policies for this industry, financial institutions can make use of the international standards described below.

### 3.9.2 International standards

In general, international standards for the oil and gas industry concern specific topics:

- **Areas of high biodiversity and protected areas**

  Oil and gas activities are especially not permitted in areas that are listed in the categories I to IV of the World Conservation Union, or listed in the UNESCO World Heritage Convention or in the Ramsar Convention on Wetlands.

  These areas are also included in the analyses for investments by the International Finance Corporation's (IFC) Performance Standard 6 concerning Biodiversity Conservation and Sustainable Management of Living Natural Resources. It determines how companies should operate in order to avoid negative consequences on areas of high biodiversity value, including impact on natural habitats as well as endangered and endemic species. The requirements in the standard have been guided by the Convention on Biological Diversity.

  Furthermore, forests identified according to the High Carbon Stock Approach, Marine Protected Areas and High Conservation Value areas should be recognised and protected.

  *This leads to assessment elements 1, 2 and 3.*

- **Crisis management**

  After the disastrous Exxon Valdez oil spill in 1989, where more than 40 million litres of oil covered the coastal areas of Alaska, the United Nations International Maritime Organization (IMO) adapted the requirements for oil transport. The amendment of 2003 on the MARPOL Convention demands that new oil tankers need to have a double hull and all large tankers with a single hull have been taken out of circulation between 2005 and 2010.

The Protocol on Preparedness, Response and Co-operation in pollution Incidents by Hazardous and Noxious Substances (OPRC-HNS Protocol, 2000) drafted by IMO aims to establish a global framework for international cooperation in order to prevent large scale incidents and the threat of maritime pollution. Parties that have ratified the HNS Protocol are expected to establish measures for polluting incidents or cooperate on a national level with other countries. Ships are obliged to have an emergency plan on board for specific incidents with *Hazardous and Noxious Substances*.

Globally, the development of norms and regulations concerning the management of oil pipelines follows the standards originating from the United States. The US system, Integrity Management (IM), is used all over the world as a 'best practice'. In Alaska there is the additional requirement that the 'Best Available Technology' (BAT) has to be applied to all oil and gas activities. An important part of such standards is that a company also has to be able to adequately respond to incidents. Globally recognised standards are:[502]

- API 1160 (American Petroleum Institute) for the implementation of Integrity Management (IM) programmes for High Consequence Areas;
- ASME B31.4 (American Society of Mechanical Engineers) standard for the design and construction of oil pipelines; and
- API 1130 standard to detect leakages *(Leak Detection Systems*).

The working group 'Oil Spill Working Group' of the IPIEC has written guidelines for crisis planning and response in case of oil disasters at sea (Oil Spill Contingency Planning and Response). These guidelines are meant for the industry and for government organisations and it is based on Industry Best Practices and on the expertise of IPIECA members the International Maritime Organisation (IMO) and the International Tanker Owners Pollution Federation (ITOPF).

The European Union had introduced a new directive 2013/30/EU on safety of offshore oil and gas operations which must improve safety on oil rigs. The directive should prevent pollution of water and coastal areas by means of strong demands regarding safety. Moreover, companies are expected to use adequate response mechanisms in order to reduce the consequences of accidents.

Investment in projects in areas that fall under the following conventions and initiatives are expressly to be avoided: forests identified with the High Carbon Stock Approach, Marine Protected Areas, High Conservation Value areas, IUCN protected areas, UNESCO World Heritage sites, areas that are listed in the categories I to IV of the World Conservation Union and the Ramsar Convention on Wetlands (see also the section on Areas of high biodiversity and protected areas).

*This leads to assessment elements* 4 *and* 5*.*

- **Waste management**

The *Convention for the protection of the Marine Environment of the North-East Atlantic* (better known as the OSPAR Convention) regulates the disposal and processing of waste from offshore oil and gas extraction and mining and serves as a basis for national legislation in the countries that have signed the OSPAR. Norway has drafted an even more stringent national standard for waste processing from offshore-oil production, the so-called Zero environmentally hazardous discharges standard. This standard requires that a large part of the drilled mud is purified so it can be injected back into the oil field.

A special type of waste is the natural gas that surfaces at the oil mining of some oil fields. This gas is often vented, or it is burnt (flaring). Both venting as well as flaring results in a huge loss of energy and contributes significantly to the greenhouse effect. The Global Gas Flaring Reduction Public-Private Partnership (GGFR), established by the World Bank, has drafted guidelines to minimise the flaring and venting of natural gas. In cooperation with GGFR and GHG Emissions Task Force the International Petroleum Industry Environmental Conservation Association (IPIECA) developed a guideline (‘*Preparing effective flare management plans: Guidance document for the oil and gas industry*’) for governments and companies that wish to try and reduce gas flaring.

The Guideline with respect to the management of waste of mining industries, drafted by the European Commission in 2006, requests that European Union member states ensure that extractive waste is managed without endangering human health or the environment; specifically water, air, soil, flora and fauna. The member states also need to take the necessary precautions to prohibit the uncontrolled abandonment, dumping and disposal of extractive waste.

Standards for the disposal of offshore drilling platforms are drafted by the OSPAR Convention in OSPAR Decision 98/3 on the Disposal of Disused Offshore Installations. This decision states that oil companies have to choose the method of dismantling that causes the least harm to the environment. In addition, companies have to make adequate provisions to overcome any environmental problems involved in dismantling. They have to take responsibility for the dismantling of their production capacity and the waste they produce and can no longer leave this to governments.

*This leads to assessment element* 6 *and* 7*.*

- **Water use**

Given the growing challenge of water scarcity, it is vital that companies and financial institutions become aware of their own influences on water related problems. Various initiatives, guidelines and standards have emerged in recent years, to help companies address water risk.

Initiatives companies could participate in and learn from are:

- The UN Global Compact’s CEO Water Mandate is a public-private initiative designed to assist companies in the development, implementation and disclosure of water sustainability policies and practices.
- The guidance by the UNEP and CEO Water Mandate on Corporate Water Accounting: An Analysis of Methods and Tools for Measuring Water Use and Its Impacts.
- The European Water Partnership; and
- The Water Footprint Network, which also has a standard on assessing a global water footprint.

There are several guidelines and water ‘footprinting’ methods as well as voluntary disclosure initiatives for calculating water use, water risk, understanding water issues and creating a sound water strategy, such as:

- The CDP’s Water Program, to calculate and publish corporate water use throughout the supply chain;
- The GEMI Water Sustainability Tool; and
- The WBCSD Global Water Tool.

Alternately, the AWS International Water Stewardship Standard is a new standard, soon to be supported by a verification process. It defines a set of water stewardship criteria and indicators for how water should be stewarded at a site and catchment level in an environmentally, socially, and economically beneficial manner.

*This leads to assessment element 8 and 9.*

- **Effects on marine life**

  In the offshore oil and gas industry, seismological research causes harm to whales and other marine mammals. To curb these effects, the JNCC guidelines were published in 2004. These comprise of a number of minimum requirements that reduce harm to marine life off the coast of the United Kingdom.

  *This leads to assessment element 8.*

- **Labour rights**

  As part of respecting human rights, it is of great importance that oil and gas companies adhere to the United Nations International Labour organisation's (ILO) main codes of conduct. These are the 1998 ILO Declaration on Fundamental Principles and Rights at Work and the Tripartite Declaration of Principles Concerning Multinational Enterprises and Social Policy. In addition, specifically for the extractive industry, the 1995 Safety and Health in Mines Convention should be taken into account. The rights of women in the extractive industry are recognised in the Iroco Declaration.

  *This leads to assessment element 11.*

- **Land rights conflicts and forced evictions**

  The right to food, water, housing and work are included in the International Covenant on Economic, Social and Cultural Rights (ICESCR).[503] These rights are connected to the non-defined right to land.

  Regarding adequate housing, governments have the obligation to guarantee security of tenure, which includes protection against forced eviction.[504] As noted by the UN Special Rapporteur on Adequate Housing: "Involuntary resettlement amounts to a forced eviction when it occurs without the provision of, and access to, appropriate forms of legal or other protection."[505] The protection measures that should be applied to all evictions are articulated in the Basic Principles and Guidelines on Development-based Evictions (2007), developed by the UN Special Rapporteur on Adequate Housing.[506] They reflect existing standards and jurisprudence on this issue, including detailed guidance on steps that should be taken prior to, during and following evictions in order to ensure compliance with relevant principles of international human rights law.

  The 11 core principles of the United Nations Special Rapporteur on the right to food, include the notion that any shifts in land use can only take place with the free, prior and informed consent of the local communities concerned. This is particularly important for indigenous communities, in view of the discrimination and marginalization they have been historically subjected to.

  In May 2011, the Tirana Declaration was adopted by over 150 representatives of civil society organisations, social movements, grassroots organizations, international agencies, and governments. According to The Declaration land acquisitions or concessions should, amongst others, be based on free, prior and informed consent of the affected land-users.

In GRI's Oil and Gas Sector Disclosures it is stated that oil and gas companies have to produce a sustainability report that addresses the rights of indigenous peoples:

- the locations where indigenous peoples live or are influenced by business activities and where an engagement has been made (OG9);
- the number of conflicts and a respective description with local communities and indigenous peoples (OG10); and
- business activities where forced relocation of people has occurred and the number of households involved in this (OG12).

*This leads to assessment elements 12 and 13.*

- **Security and law enforcement**

Companies may become involved in the violation of human rights when (private or public) companies use violence against people who live in the surroundings of the company. This question is dealt with in the UN Code of Conduct for Law Enforcement Officials and the UN Basic Principles on the Use of Force and Firearms by Law Enforcement Officials. Based on this code of conduct and on these principles the Voluntary Principles on Security and Human Rights were developed in a multi stakeholder process. They provide guidelines for companies with regard to, amongst others, their security methods.

*This leads to assessment element 14.*

- **Access to remedy**

Oil companies need to respect the rights of local communities affected by their operations. The responsibility to respect requires that companies avoid causing or contributing to adverse human rights impacts through their own activities and seek to prevent or mitigate impacts that are directly linked to their operations by their business relationships. According to the United Nations Guiding Principles on Business and Human Rights (UNGPs), if a company identifies a risk or is contributing to an adverse impact, it should cease or prevent its contribution and to mitigate any remaining impacts to the greatest extent possible. Finally, the enterprise should provide for or cooperate in their remediation through legitimate processes. They should establish or participate in effective operational-level grievance mechanisms for individuals and communities who may be adversely impacted.[507]

*This leads to assessment element 15.*

- **Transparency of financial flows**

In the Extractive Industries Transparency Initiative (EITI), a coalition of governments, companies, social organisations and investors has drafted criteria for governments of countries where oil and gas extraction and mining take place. Governments are expected to fully publish all revenues they receive from these activities.

The Publish What You Pay coalitions, in which over 300 social organisations cooperate, advocates that the oil companies also make their payments to governments publicly known. This means that companies have to report their tax payments in the countries where they operate, but also on royalties, payments for concessions and such. Also, the important contracts and agreements between governments and oil companies and all bank loans related to oil and gas extraction and mining should be made public.

The Global Reporting Initiative has drafted the G4 Sustainability Reporting Guidelines on how to write sustainability reports. It states that organisations should report on the payments that they make to governments (EC1) and on the amounts that companies receive from governments (EC4). In its Oil and Gas Sector Disclosures it has been added that oil companies have to report the payments to governments for every country where they operate per type (taxes, royalties, payments for concessions, bonuses, etc.).[508]

*This leads to assessment elements 16, 17 and 18.*

- **Good governance**

  In order to minimise the negative consequences of the *resource curse*, it is important that the development of the oil and gas extraction and mining is combined with the development of capable and reliable governance. The World Bank Extractives Industries Review (EIR) advises that private investments in oil and gas extraction and mining are not encouraged in countries where governance is weak. It also establishes that the quality of the governance has to meet explicit conditions before any oil and gas project can be financed by the World Bank.

  The UNGPs points to heightened risks of involvement in gross human rights abuses in conflict-affected areas. A company should manage its own impact in order to prevent involvement in human rights violations.

  The OECD Risk Awareness Tool for Multinational Enterprises in Weak Governance Zones could be helpful detecting areas were strong governance is needed to avoid human rights abuses or to refrain from doing business.

  *This leads to assessment element 19.*

- **Unconventional oil sources**

  Due to a still ever-increasing demand for fossil fuels, unconventional oil sources - such as the Canadian tar sand fields, oil shale in the United States and extracting shale gas or coal gas - are economically attractive, although extracting these unconventional oil supplies is highly polluting. Extracting these hydrocarbons is also very $CO_2$-intensive and therefore disastrous for the environment. As is the use of great quantities of water in mining oil and gas supplies, which can have huge consequences for the water supply and can lead to loss of agricultural land and nature reserves.

  There are no international guidelines yet which regulate how to deal with unconventional oil supplies. However, the Fair Finance Guide network considers extracting oil from tar sand fields, from oil shale, from liquefied coal as well as extracting shale gas and arctic drilling for oil and gas as unacceptable activities.

  *This leads to assessment elements 20 to 24.*

- **Sustainability reporting**

  The Global Reporting Initiative has drafted guidelines on how to write sustainability reports. Besides the general G4 Sustainability Reporting Guidelines it also provides sector guidance for a number of industrial sectors. The Oil and Gas Sector Disclosures includes guidelines on companies active in exploration, extraction, production, refining, and transport and sale of oil, gas and petrochemicals. For small and medium enterprises (SMEs), less elaborate sustainability reporting is required. SMEs can report on the GRI indicators that are relevant to their operations, for example by following the High5! Approach.

  *This leads to assessment elements 25 and 26.*

- **Procurement and supply chains**

  Companies are often part of long production chains. They can monitor one another and question how they respect local and national legislation and international norms regarding social, economic and environmental issues. The requirements that companies set for their suppliers can be included in contractual agreements. The importance of this also recognised in the OECD Guidelines for Multinational Enterprises since its revision in 2011.

  Also the ISO 26000 guideline recognises the importance of supply chain responsibility, because "the impacts of an organization's decisions or activities can be greatly affected by its relationships with other organizations." A companies' sphere of influence includes relationships within and beyond an organization's supply chain.[509]

  The UNGPs include a due diligence process in order to identify, prevent, mitigate and account for how companies address their adverse human rights impacts. The process "should cover adverse human rights impacts that the business enterprise may cause or contribute to through its own activities, or which may be directly linked to its operations, products or services by its business relationships."[510]

  *This leads to assessment elements 27 and 28.*

### 3.9.3 Assessment elements

The investment policy of financial institutions on the oil and gas sector has to emphasise that the main challenge for the oil and gas sector is the further development of sustainable energy provisions. In addition, the policies of financial institutions have to include social and environmental norms for the oil and gas sector.

The following elements are crucial for a policy regarding the companies a financial institution invests in or finances:

1. Companies prevent negative impact on protected areas that fall under the categories I-IV of the International Union for Conservation of Nature.
2. Companies prevent negative impact on UNESCO World Heritage sites.
3. Companies prevent negative impact on protected areas that fall under the Ramsar Convention on Wetlands.
4. Companies mitigate the chance of accidents (oil spills, leakages) by making use of the best available techniques and have a solid road map for crisis situations (a so called 'contingency plan').
5. Companies do not operate in locations where the consequences of an accident for the environment are unmanageable.

6. Companies reduce waste from oil and gas extraction and mining, especially the flaring of natural gas, and manage and process this in a responsible way.
7. Companies include the environmental and health effects of the dismantling of production facilities, especially of *offshore* drilling platforms, in plans for the development of new projects.
8. Companies conduct water scarcity impact assessments and prevent negative impacts in water scarce regions.
9. Companies do not start new operations in areas where water scarcity is pre-existing and operations would compete with the needs of communities.
10. Companies reduce the effects of seismological research on whales and other marine mammals.
11. Companies respect the ILO Declaration on Fundamental Principles and Rights at Work.
12. Companies prevent conflicts over land rights and acquire natural resources only by engaging in meaningful consultation with local communities and obtaining free, prior and informed consent (FPIC) when it concerns indigenous peoples.
13. Companies prevent conflicts over land rights and acquire natural resources only with free, prior and informed consent (FPIC) of the land users involved.
14. Companies follow the Voluntary Principles on Security and Human Rights for the protection of their employees and de company sites.
15. Companies have processes to enable the *remediation* of any adverse human rights impact which they cause or to which they contribute.
16. Companies pay the taxes owed in each country where they operate.
17. For each country in which companies operate, they report country-by-country on their revenues, profit, FTEs, subsidies received from governments and payments to governments (e.g. withholding taxes, payments for concessions and company tax).
18. Offering, promising, giving, or requiring, either directly nor indirectly, bribes or other undue advantages in order to acquire or to maintain assignments or other undue advantages, is unacceptable.
19. Companies only operate in weak governance zone or conflict-affected areas if they are able to demonstrate that they are not causing or contributing to human rights abuses.
20. Extracting oil from tar sands is unacceptable.
21. Extracting oil from oil shale is unacceptable.
22. Extracting fuel from liquefied coal is unacceptable.
23. Extracting shale gas is unacceptable.
24. Arctic drilling for oil and gas is unacceptable.
25. Companies publish a sustainability report that may contain (a number of) the Standard Disclosures from the GRI G4 Sustainability Reporting Guidelines.
26. Large enterprises and multinational enterprises publish a sustainability report that is set up in accordance with the G4 Sustainability Reporting Guidelines, which includes the Oil and Gas Sector Disclosures (OGSD).
27. Companies integrate social, economic and environmental criteria in their procurement and operational policies.[xx]
28. Companies include clauses on the compliance with social, economic and environmental criteria in their contracts with subcontractors and suppliers.

xx If the financial institution has no specific sector policies or does not mention this in its sector policies, but does mention this in cross-cutting policies for at least three themes, the financial institution is deemed to comply with this element.

## 3.10 Power generation

### 3.10.1 What is at stake?

Power generation is essential to meet society's demands for energy, and is central to efforts to achieve sustainable development and poverty reduction. There are many pressures on energy suppliers to generate power in a manner that offers security of supply, is affordable for consumers, and which has a minimal level of negative environmental impacts.

A crucial concern regarding power generation is its impact on climate change. Energy, including power and heat generation for businesses and households as well as energy for transport, is the largest source of anthropogenic (man-made) greenhouse gas emissions globally, accounting for roughly 66% of all global emissions. Generation of power and heat is the largest component of this.[511]

According to the world's leading authority on climate change, the Intergovernmental Panel on Climate Change (IPCC), most scenarios in which dangerous climate change is avoided require low carbon sources of power (including renewable energy, nuclear power and fossil fuels with carbon capture and storage) to reach around 80% of global power generation by 2050, with power generation from fossil fuels such as oil, coal and gas to be phased out almost entirely by 2100, unless accompanied by carbon capture and storage (CCS). Despite many years of research, CCS is not yet available at a commercial scale. The IPCC also notes that such mitigation scenarios would lead to devaluation of fossil fuel assets and reduced revenues for the coal and oil trade, providing a financial incentive for financial institutions to decrease their exposure to fossil fuels.[512]

However climate change is not the only environment or social issue arising from power generation from fossil fuels. Coal-fired power plants have particularly egregious impacts. As well as releasing carbon dioxide, burning coal emit pollutants including sulphur dioxide, nitrogen oxides, and mercury compounds. Fine particles from coal-fired power plants kill an estimated 13,200 people each year in the United States alone, according to the Boston-based Clean Air Task Force.[513] Coal plants also use large quantities of water, which becomes polluted with heavy metals such as lead and arsenic during use. Soil at coal-fired power plant sites can also become contaminated with various pollutants from the coal and take a long time to recover, even after the power plant closes down.[514] Gas plants are also associated with emissions of air pollutants including carbon dioxide and nitrous oxides, although these are lower than for coal.[515]

Nuclear power is considered a low carbon power source by the IPCC, but its use remains highly controversial. The dangers of nuclear power are illustrated by accidents including those at Chernobyl, Ukraine in 1986, at Tokaimura, Japan, in 1999, and at Fukushima, Japan in 2011. Nuclear power also produces a legacy of radioactive nuclear waste, for which the issue of long-term safe storage remains unsolved. For these reasons, as well as for economic reasons (in particular the cost of decommissioning nuclear power stations at the end of their useful life), major environmental groups including Greenpeace and WWF continue to oppose nuclear power.[516]

Among power generation technologies considered “renewable”, large dams are the most controversial. According to the final report of the World Commission on Dams (WCD), published in November 2000, globally, the construction of large dams has driven between 40 and 80 million people away from their homes.[517] Besides these direct impacts of displacement, communities’ livelihoods can be impacted by flooding (upstream), disturbing of water streams and fishery (downstream), violations of indigenous land rights and disruption of local food production.[518] In addition, dams (including dams for water management) have interrupted or reclaimed 60% of the world’s rivers, with often huge and irreversible effects on the natural environment and ecosystems. Research also shows that hydropower plants may produce large volumes of methane gas, a very potent greenhouse gas that arises from the decay of vegetation on the bottom of the reservoir. The methane gas is released when the water is led through the turbines. In some cases, hydropower plants produce more greenhouse gas than a power plant of comparable scope running on fossil fuel.[519]

Given the serious, irreversible ecological impacts of dams, civil society organizations such as International Rivers say that dam-based hydropower cannot be considered a renewable source of power. However this does not mean that all hydropower is problematic: many smaller (‘micro’ and ‘pico’) hydropower projects operate without damming rivers, and these projects can offer low-emissions energy without substantial negative impacts.[520] Ecological impacts of dams depend on: scale of river fragmentation compared to existing dams, disruption of main river connectivity, new road building needed, new transmission lines needed, and direct environmental impacts from location near protected area, harming fish productivity and biodiversity and blocking of fish migration routes, or flooding of over 100 $km^2$ of forests.[521]

In general, power generation using other forms of renewable energy, including wind power, solar power, geothermal power, smaller scale hydroelectric power as well as tidal marine power, are responsible for much lower emissions of greenhouse gasses than fossil fuels (although due to the emissions from the construction, maintenance and decommissioning of technologies like solar panels and wind farms, these technologies are not completely free of harmful emissions). It is generally agreed by environmental groups and climate scientists that a substantial increase in investments in renewable energy is needed, alongside investment in energy efficiency, to decarbonize the energy sector and meet emissions reduction targets.

However, financial institutions financing power generation from renewable energy must also be mindful of its potential impacts, in terms of factors such as impacts on land use, wildlife and local communities.

When developing policies for the power generation sector, financial institutions can make use of the international standards described below.

### 3.10.2 International standards

The most important international standards concerning power generation are summed up below.

- **Transition to low carbon economy**

  The WWF study Climate Solution shows that it is very probable that well-known alternative energy sources and technologies can be ready for use between now and 2050 in order to meet the predicted doubling of the global energy demand, provided that in the coming 5 years decisions will be taken to enable this. This development will ensure a reduction of 60 to 80% of current $CO_2$ emissions, which is necessary to prevent dangerous climate change. This reduction can be achieved without the use of nuclear energy, non-sustainable biomass and non-sustainable types of hydropower.[522]

The third part of the IPCC's Fifth Assessment Report, published in April 2014, focused on mitigating, or avoiding, climate change, showed that the world must significantly reduce its reliance on fossil fuels in the coming decades. The IPCC projected that over the next two decades (2010 to 2029), annual investment in conventional fossil fuel technologies for the electricity supply sector would decline, with a median projected rate of decline being around 20%. At the same time, annual investment in low-carbon electricity supply (including renewable energy, nuclear power and electricity generation with carbon capture and storage) is projected to rise by 100% compared to 2010 on the same median basis.

An Emissions Performance Standard (EPS) is a standard for power generation based on the level of carbon dioxide emissions produced per unit of energy, normally expressed in grams of carbon dioxide emitted per kilowatt hour of energy produced ($gCO_2$/kWh). Emissions Performance Standards have been introduced by governments, for example to impose limits on the level of emissions permitted for new power stations, and also by some financial institutions to screen out finance for power stations which do not meet the standard.

An example of the latter is the EPS introduced by the European Investment Bank (EIB), which is applied to all fossil fuel generation projects to screen out investments whose carbon emissions exceed a threshold level. This threshold has been set at a level which reflects existing EU and national commitments to limit carbon emissions. In the first instance the EPS has been be set at 550$gCO_2$/kWh. This will rule out any further lending to regular coal and lignite power plants. The EIB agreed that the Emissions Performance Standard would be kept under review and that more restrictive commitments could be considered in the future.[523]

*This leads to assessment elements 1 to 8.*

- **Areas of high biodiversity and protected areas**

Various international agreements require the protection of ecosystems and natural habitats:

- The biodiversity in areas that are important on environmental and cultural grounds falls under the protection of the Unesco World Heritage Convention.
- For *wetlands* (swamps and bogs), which are rich in biodiversity, there is the Ramsar Convention on Wetlands that ensures protection and proper management of these areas.
- The World Conservation Union (IUCN) has developed a system that categorises natural areas in six categories and indicates in which areas biodiversity has to be protected (category I to IV). In addition, the IUCN provides guidelines for companies on how to deal with fields that fall within these Protected Area Management Categories*.* In 2000, a resolution was adopted on the IUCN World Conservation Congress that calls upon all states not to allow investments in oil, gas and extractive industry projects in the protected areas (categories I to IV).

These areas are also included in the analyses for investments by International Finance Corporation's (IFC) Performance Standard 6 concerning Biodiversity Conservation and Sustainable Management of Living Natural Resources. It determines how companies should operate in order to avoid negative consequences on areas of high biodiversity value, including impact on natural habitats as well as endangered and endemic species. The requirements in the standard have been guided by the Convention on Biological Diversity.

*This leads to assessment elements 9, 10 and 11.*

- **Land rights conflicts and forced evictions**

  The right to food, water, housing and work are included in the International Covenant on Economic, Social and Cultural Rights (ICESCR).[524] These rights are connected to the non-defined right to land.

  Regarding adequate housing, governments have the obligation to guarantee security of tenure, which includes protection against forced eviction.[525] As noted by the UN Special Rapporteur on Adequate Housing: "Involuntary resettlement amounts to a forced eviction when it occurs without the provision of, and access to, appropriate forms of legal or other protection."[526] The protection measures that should be applied to all evictions are articulated in the Basic Principles and Guidelines on Development-based Evictions (2007), developed by the UN Special Rapporteur on Adequate Housing.[527] They reflect existing standards and jurisprudence on this issue, including detailed guidance on steps that should be taken prior to, during and following evictions in order to ensure compliance with relevant principles of international human rights law.

  The 11 core principles of the United Nations Special Rapporteur on the right to food, include the notion that any shifts in land use can only take place with the free, prior and informed consent of the local communities concerned. This is particularly important for indigenous communities, in view of the discrimination and marginalization they have been historically subjected to.

  In May 2011, the Tirana Declaration was adopted by over 150 representatives of civil society organisations, social movements, grassroots organizations, international agencies, and governments. According to The Declaration land acquisitions or concessions should, amongst others, be based on free, prior and informed consent of the affected land-users.

  *This leads to assessment elements 12 and 13.*

- **Access to remedy**

  Companies need to respect and guarantee the rights of local communities affected by the construction and activities of power generation operations. Companies may not directly, indirectly, or implicitly cooperate in violating human rights. According to the United Nations Guiding Principles on Business and Human Rights (UNGPs), if a company identifies a risk or is contributing to an adverse impact, it should cease or prevent its contribution and mitigate any remaining impacts to the greatest extent possible. Finally, the enterprise should provide or contribute to a remedy.

  *This leads to assessment elements 14.*

- **Standards for dams and hydropower**

  The most authoritative international guidelines for dam projects were drafted in November 2000 by the World Commission on Dams (WCD). The WCD was established by the World Bank and the World Conservation Union and comprises of twelve experts. In a series of multi-stakeholder meetings, the WCD has raised virtually all environmental and social issues associated with large dam construction. Based on this, the committee has drafted a series of recommendations, on which future dam projects can base their environmental and social plans. Also, financial institutions can use these guidelines as a base for their investment policies.[528]

The recommendations of the WCD are drafted around the issue of who carries the rights and who is responsible for the risks in dam projects. The recommendations themselves comprise of seven strategic priorities and supported principles:

- obtaining public consent;
- solid assessment of alternatives;
- standard for existing dams;
- the preservation of rivers as a source of livelihood;
- respect of rights and sharing revenues;
- focus on compliance; and
- sharing rivers for peace, development and safety.

Any problems that occur during the construction of dams also occur in similar water infrastructure projects, such as navigation work, pumping water between reservoirs and large irrigation projects. Therefore, the above described principles should also apply to the development of these types of projects.

*This leads to assessment elements 15 and 16.*

- **Standards for biofuels**

In 2007 a Dutch committee developed sustainable criteria for biofuels. These so-called Cramer Criteria were formalised in March 2009 as the NTA 8080:2009 Sustainability criteria for biomass for energy purposes.[529]

In 2010, the Steering Board of the Roundtable on Sustainable Biomaterials (RSB) approved Version 2 of the principles and criteria for sustainable biofuel production, after three years of consultation with biofuels stakeholders. The RSB offers Global Standards that apply to any type of feedstock worldwide and EU-RED Standards that apply to feedstock entering the EU market and comply with the EU Renewable Energy Directive regarding land-use and GHG criteria.[530] The global RSB Principles are: [531]

1. Biofuel operations shall follow all applicable laws and regulations.
2. Sustainable biofuel operations shall be planned, implemented, and continuously improved through an open, transparent, and consultative impact assessment and management process and an economic viability analysis.
3. Biofuels shall contribute to climate change mitigation by significantly reducing lifecycle GHG emissions as compared to fossil fuels.
4. Biofuel operations shall not violate human rights or labor rights, and shall promote decent work and the well-being of workers.
5. In regions of poverty, biofuel operations shall contribute to the social and economic development of local, rural and indigenous people and communities.
6. Biofuel operations shall ensure the human right to adequate food and improve food security in food insecure regions.
7. Biofuel operations shall avoid negative impacts on biodiversity, ecosystems, and conservation values.
8. Biofuel operations shall implement practices that seek to reverse soil degradation and/or maintain soil health.
9. Biofuel operations shall maintain or enhance the quality and quantity of surface and ground water resources, and respect prior formal or customary water rights.
10. Air pollution from biofuel operations shall be minimized along the supply chain.
11. The use of technologies in biofuel operations shall seek to maximize production efficiency and social and environmental performance, and minimize the risk of damages to the environment and people.

12. Biofuel operations shall respect land rights and land use rights.

The RSB standards are accompanied by a set of guidelines such as the RSB-Impact Assessment Guidelines and the RSB-Screening Tool.[532]

In September 2013 the European Parliament had voted in favour of regulation that reduces the obligation to blend biofuels to 6%. The European Parliament thus intends to reduce the $CO^2$ emissions of the cultivation for biofuel.

*This leads to assessment element 17.*

- **Sustainability reporting**

  The Global Reporting Initiative has drafted guidelines on how to write sustainability reports. Besides the general G4 Sustainability Reporting Guidelines it also provides sector guidance for a number of industrial sectors. The Electric Utilities Sector Disclosures includes guidelines on the construction of the infrastructure of power generation companies. For small and medium enterprises (SMEs), less elaborate sustainability reporting is required. SMEs can report on the GRI indicators that are relevant to their operations, for example by following the High5! Approach.

  *This leads to assessment elements 18 and 19.*

- **Procurement and supply chains**

  Companies are often part of long production chains. They can monitor one another and question how they respect local and national legislation and international norms regarding social, economic and environmental issues. The requirements that companies set for their suppliers can be included in contractual agreements. The importance of this also recognised in the OECD Guidelines for Multinational Enterprises since its revision in 2011.

  Also the ISO 26000 guideline recognises the importance of supply chain responsibility, because “the impacts of an organization's decisions or activities can be greatly affected by its relationships with other organizations.” A companies’ sphere of influence includes relationships within and beyond an organization’s supply chain.[533]

  The UNGPs include a due diligence process in order to identify, prevent, mitigate and account for how companies address their adverse human rights impacts. The process “should cover adverse human rights impacts that the business enterprise may cause or contribute to through its own activities, or which may be directly linked to its operations, products or services by its business relationships.”[534]

  *This leads to assessment elements 20 and 21.*

### 3.10.3 Assessment elements

Financial institutions investing in, or financing companies in the energy sector should carefully consider how they can orient their investments to support the transition to a low-carbon economy, in line with the pathways suggested by the IPCC. This may be through choosing to support exclusively renewable energy generation, or by setting out a clear pathway to reduce finance for fossil fuels and other controversial energy sources and replace this with low-carbon finance.

Financial institutions investing in, or financing companies in the construction of dam projects should develop sector policies for these investments in which the recommendations of the World Commission on Dams (WCD) are included.[535] This policy should at least be applicable to all large dam projects, but ideally includes all important water infrastructure projects.

The following elements are crucial for a policy regarding the financial institution's internal operations:

1. The financial institution finances companies involved in renewable energy generation (wind, solar, small and medium scale hydro power, geothermal power, tidal power, etc.).
2. The financial institution has a measurable target to increase its finance for renewable energy generation.
3. The financial institution has a measurable target to reduce either its total amount of finance for fossil fuel-fired power generation, or to reduce finance for fossil fuel-fired power generation, relative to its finance for renewable energy generation.

The following elements are crucial for a policy regarding the companies a financial institution invests in or finances:

4. Unabated coal-fired power generation (i.e. without operational carbon capture and storage) is unacceptable
5. Coal-fired power generation is unacceptable.
6. Fossil fuel-fired power generation is unacceptable.
7. Nuclear energy is unacceptable.
8. Large scale hydropower generation is unacceptable.
9. Companies prevent negative impact on protected areas that fall under the categories I-IV of the International Union for Conservation of Nature.
10. Companies prevent negative impact on UNESCO World Heritage sites.
11. Companies prevent negative impact on protected areas that fall under the Ramsar Convention on Wetlands.
12. Companies prevent conflicts over land rights and acquire natural resources only by engaging in serious consultation with local communities and obtaining free, prior and informed consent (FPIC) when it concerns indigenous peoples.
13. Companies prevent conflicts over land rights and acquire natural resources only with free, prior and informed consent (FPIC) of the land users involved.
14. Companies have processes to enable the *remediation* of any adverse human rights impact to which they cause or to which they contribute.
15. The construction of dams complies with the 7 principles of the World Commission on Dams .
16. The construction of all water infrastructure projects complies with the 7 principles of the World Commission on Dams.
17. The production of biomaterials complies with the 12 principles of the Roundtable on Sustainable Biomaterials.
18. Companies publish a sustainability report that may contain (a number of) Standard Disclosures from the GRI Guidelines on level G4 Sustainability Reporting Guidelines.
19. Large enterprises and multinational enterprises publish a sustainability report that is set up in accordance with the GRI G4 Sustainability Reporting Guidelines, which includes the Electric Utilities Sector Disclosure (EUSD).
20. Companies integrate social, economic and environmental criteria in their procurement and operational policies.[xxi]

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xxi If the financial institution has no specific sector policies or does not mention this in its sector policies, but does mention this in cross-cutting policies for at least three themes, the financial institution is deemed to comply with this element.

21. Companies include clauses on the compliance with social, economic and environmental criteria in their contracts with subcontractors and suppliers.

# Chapter 4 Operational themes

## 4.1 Consumer protection

### 4.1.1 What is at stake?

The consumer is an essential actor in financial market, and as such, their problems require attention from the other agents. A major part of financial services and products are addressed to consumers: current and saving accounts, personal loans, debit and credit cards, mortgage loans, insurance, pensions and annuities and investment products. In general, these kind of transactions are the domain of retail banks and insurance companies.

The characteristics of these services and their impact on consumers' lives reinforce the need for financial institutions to be responsible in their relationship with consumers. With this objective in mind, financial institutions must take into account the importance of consumer rights on development, governance and commercialization of financial services.

Both the financial inclusion trends and increasingly sophistication of financial market has important implications for financial institutions. These factors drive changes in the behaviour of consumers and banks and can affect the stability of the system. The international financial crisis in April 2008 motivated a serious reflection on the behaviour of financial market agents. The effects of the crisis shown that weak consumer protection resulted in a high risk to the entire financial system. As underlined by the European Commission, it lead to a lack of confidence among all actors, in particular consumers.[536] Abusive loan products and practices reduced the reliability and the safety of the system and consumers lost confidence in the financial services.

The world economic crisis after the collapse of Lehman Brothers, in September 2008, revealed the risks involved with mixing global financial markets with the real economy. Basic needs like housing and retail bank products like mortgage loans, were fixed into complex and risky financial products, leading to the subprime mortgage crisis, foreclosures and the devaluation of housing-related securities.

The World Bank estimates that 150 million new consumers join the market for financial services every year, many in countries with low levels of consumer protection.[537] However, according to Consumers International (CI), "*weak financial consumer protection is a problem shared by consumers in countries with well-established financial services as well as consumers in countries where the sector is relatively new*."[538] The high number of complaints reported by CI members in all regions is a strong indicator that the violation of consumer rights is a concern not only in the countries where financial services have a low level of maturity.[539]

According to CI, consumer education is a necessary but rather insufficient response to the problem. Protecting the interest of consumers in the financial sector poses a great responsibility not only on the national regulatory agencies but also on the financial sector, more in particular on national and international banks.[540]

Moreover, financial services have become a basic need to individuals in the modern society, since they enable consumers to solve current and unexpected necessities, by providing payment services, access to loans, money transfers, investment solutions and insurance against risk. Financial services must be considered 'credence goods'. Even though they are repeatedly purchased, their utility is difficult for the consumer to define, and their features are not easily assessed. Indeed, the financial sector is characterised by a number of critical factors, which, according to CI, include:[541]

• *the complexity of the products, and of product information;*
• *the high risks associated with many products;*
• *the fast changing nature of many of the products;*
• *their 'virtual' non-tangible nature, and*
• *the long-term nature of many transactions which means that consumers do not make regular purchases, and therefore do not develop an expertise in the market.*

The lack of consumer protection in the financial sector can have severe social and economic consequences. Amongst which is the financial crisis itself, due to the lack of transparency of banks in relation to the market, and also the growth of debt and over-indebtedness of financial institutions' customers. Because of the impact on the lives of individual people and society as a whole, consumers must be aware of and understand the risks and particular conditions of each financial product.

Consumers International has therefore defined the responsibility of financial service providers to provide "*clear, sufficient, reliable, comparable and timely information, suitable in these respects for the consumer to compare and contrast and to make an informed decision.*"[542]

In order to provide sufficient information, financial institutions should firstly be transparent when advertising their products. Contractual terms and conditions must be clear during purchase phase. Consumers then need to be aware of risks and implications during all the lifetime of products. To some products such as pensions and mortgages, consumers need a continuous monitoring, since they must control their disbursements and identify eventual required changes (e.g. early repayment or debt renegotiation).[543]

Below, we identify the most recurrent practices committed by financial institutions that violate consumers' rights:[544]

- **Complaint mechanisms**

    - Financial institutions present lack of transparency by not informing how many consumers complaints they receive;
    - Financial institutions do not commit on a policy to reduce consumers complaints;

- **Quality and transparency of services**

    - Large commercial banks do not offer efficient customer services at bank branches, and many consumers have to wait for a long time in queues;
    - Financial institutions usually try to push at consumers services that they don't need or that are inappropriate for their financial risk profile. It is very common to observe tie-in sales (for example: a person wants to open an account but is obliged to contract an insurance);
    - Commonly consumers are not properly informed about changes of fees values or additional charges for bank services;
    - Financial institutions do not provide accessibility for customers with disabilities and special needs at all physical agencies, electronic services and electronic devices such as mobile apps, or at internet banking;

- **Protection against fraud**

    - Banks do not assume their responsibilities regarding clients' safety in case of robbery, theft and fraud involving customers in bank branches, ATM or internet and authorized agents' malpractices;

- Banks delegate the operation of some bank services to third parties, like drugstores, supermarkets or lottery stores (so-called banks correspondents). Banks do not assume their responsibilities regarding customers' safety on financial operations taken place at the correspondents and authorized agents;

- **Protection against over-indebtedness**

  - Financial institutions do not have a policy to avoid over-indebtedness and to promote conscious credit. Many of them have lack of transparency on granting credit conditions, and products requirements, guarantees and criteria of contracting. This results in over-indebted customers, a very dramatic issue at developing countries;
  - There is lack of transparency by financial institutions about their policies/procedures of debts collection. These procedures must be clear and avoid practices of coercion and embarrassment.

The aim of the Fair Finance Guide is to compare the policies of financial service providers, address internationally recognized standards as a framework for the development of policies and codes of conduct, and as such contribute to improving consumer protection measures and procedures.

In order to ensure the financial stability and fair practices of financial institutions, they should integrate financial consumer protection with financial inclusion policies. The theme Financial Inclusion therefore should preferably be researched in combination with the theme Consumer protection, as this theme also includes some aspects that must be taken into account when we assess financial inclusion policies.

### 4.1.2 International standards

Consumers have some basic and internationally recognized rights, such as the right to information, to prior knowledge of contracts, to choose services with freedom and proper information, to security, privacy and data protection, the right to financial education, to over-indebtedness prevention mechanisms, to have free and effective conflict resolution solutions.

With regard to consumer rights and protection in the financial sector the following aspects are relevant:

- **Transparency on services, risks and fees**

  According to the OECD, the complexity of financial services grows rapidly. "*The availability of information has grown both in quantity and complexity and the pace of change, in terms of new product developments, product innovations, and technological advances, has increased dramatically. Building and maintaining consumer confidence and trust in financial markets promotes efficiency and stability and helps to create positive outcomes for both financial institutions and their customers*."[545]

  The OECD, the Financial Stability Board (FSB) and other relevant international organisations worked together to develop common principles on consumer protection in the field of financial services, as a response to the G20 Finance Ministers and Central Bank Governors call in February 2011. As result, the organizations launched the G20 High-Level Principles on Financial Consumer Protection, designed to assist the efforts to enhance financial consumer protection.[546]

Regarding Principle 4 on Disclosure and Transparency, the update report on the implementation of the principles describes that consumers should be provided with key information about the product or service: [547]

*"Financial services providers and authorised agents should provide consumers with key information that informs the consumer of the fundamental benefits, risks and terms of the product. They should also provide information on conflicts of interest associated with the authorised agent through whom the product is sold. In particular, information should be provided on material aspects of the financial product. Appropriate information should be provided at all stages of the relationship with the customer. Standardised pre-contractual disclosure practices (e.g. forms) should be adopted where applicable and possible to allow comparisons between products and services of the same nature."*

Moreover, in the same document Effective Approaches 28 to 31 describes guidelines for financial institutions on promotional material: *All financial promotional material should be accurate, honest, understandable and not misleading.*[548]

The importance of this was also recognised in the OECD Guidelines for Multinational Enterprises on consumer interests. The guidelines identify two points that enterprises should take into account to give more transparency for products and services and which to some extent also apply to financial services. They should:[549]

- *"Provide accurate, verifiable and clear information that is sufficient to enable consumers to make informed decisions, including information on the prices and, where appropriate, content, safe use, environmental attributes, maintenance, storage and disposal of goods and services;*
- *Where feasible this information should be provided in a manner that facilitates consumers' ability to compare products;*
- *Not make representations or omissions, nor engage in any other practices, that are deceptive, misleading, fraudulent or unfair;*
- *Support efforts to promote consumer education in areas that relate to their business activities, with the aim of, inter alia, improving the ability of consumers to:*
  - *make informed decisions involving complex goods, services and markets;*
  - *better understand the economic, environmental and social impact of their decisions and*
  - *support sustainable consumption."*

The general objective of the UN Guidelines for Consumer Protection is "*taking into account the interests and needs of consumers in all countries, particularly those in developing countries; recognizing that consumers often face imbalances in economic terms, educational levels and bargaining power; and bearing in mind that consumers should have the right of access to non-hazardous products, as well as the right to promote just, equitable and sustainable economic and social development and environmental protection*."[550]

In order to achieve such objectives, two principles that orient the guidelines are directly related to transparency on the relationship with consumers:

- The promotion and protection of the economic interests of consumers;
- Access of consumers to adequate information to enable them to make informed choices according to individual wishes and needs.

During the current process of revision of the UN Guidelines for Consumer Protection, conducted by the United Nations Conference on Trade and Development (UNCTAD), financial services is one of the relevant matters that all countries agreed to consider.[551]

The Draft Resolution of the revision process of the UN Guidelines for Consumer Protection for consideration by the General Assembly financial services (addressed under letter L) establishes that Member States should work towards establishing, among other requirements: [552]

- *A regulatory framework that promotes cost efficiency and transparency for remittances, such that consumers are provided with clear information about prices, rates, fees and any other costs associated with the money transfers;*
- *Fair treatment and proper disclosure, ensuring that financial institutions are also responsible and accountable for the actions of their authorized agents. When the possibility of a conflict of interest arises between the provider and a third party, this should be disclosed to the consumer;*
- *Objective and adequate advice, and clear, concrete, complete and comparable information about the services offered.*

The European Union has developed several directives in order to promote legislation or voluntary codes of conducts on responsible money lending. The Directive 2008/48/EC on credit agreements for consumers (the "Consumer Credit Directive") was adopted on 23 April 2008 and Member States had to transpose it into national law before 12 June 2010. The Consumer Credit Directive aims at fostering the integration of the consumer credit market in the EU and ensuring a high level of consumer protection by focusing on transparency and consumer rights. It stipulates that a comprehensible set of information should be given to consumers in good time, before the contract is concluded and also as part of the credit agreement.[553]

In order to allow consumers to compare more easily the various offers and to better understand the information provided, creditors have to provide pre-contractual information in a standardised form (Standard European Consumer Credit Information, 2001/193/EC, annex 2).[554] Moreover, they will also provide consumers with the Annual Percentage Rate of Charge (“APR”), which is a single figure, harmonised at EU level, representing the total cost of the credit. Directive 2011/90/EU has amended the assumptions for its calculation.[555]

*This leads to assessments elements 1, 9, 14 and 15.*

- **Quality of consumer service**

Financial institutions have to ensure that the quality of their consumer services are provided in accordance with consumer rights and protection policies and practices. Principle 6 “Responsible Business Conduct of Financial Services Providers and their Authorised Agents” of the G20 High-Level Principles on Financial Consumer Protection presents guidelines on this aspect:[556]

- **Best Interest**: Financial services providers and authorised agents should have as an objective, to work in the best interest of their customers and be responsible for upholding financial consumer protection
- **Assessing Consumer Needs**: Depending on the nature of the transaction and based on information primarily provided by customers, financial services providers should assess the related financial capabilities, situation and needs of their customers before agreeing to provide them with a product, advice or service.
- **Staff Training**: Staff of financial services providers and authorised agents (especially those who interact directly with customers) should be properly trained and qualified.

- **Remuneration Structure**: The (internal) remuneration structure for staff of both financial services providers and authorised agents should be designed to encourage responsible business conduct, fair treatment of consumers and to avoid conflicts of interest. The remuneration structure should be disclosed to customers where appropriate, such as when potential conflicts of interest cannot be managed or avoided.
- **Responsibility for authorised agents**: Financial services providers should also be responsible and accountable for the actions of their authorised agents.

Similarly to G20 High-Level Principles, Consumers International (CI) concludes in its report for responsible lending a principle that aims to avoid conflicts of interest caused by remuneration structure for staff that "Lenders' business practices should incentivise customer service not sales".[557]

*This leads to assessment elements 17, 18, 19 and 20.*

- **Non-discriminatory treatment**

In the context of their responsibility to respect Human Rights, financial institutions have to provide access to their services and products fairly and without discrimination.
The commitment to provide accessibility for customers with disabilities and special needs is included in the guidelines to UN States Parties, defined by the UN Convention on the Rights of Persons with Disabilities in 2006. The general obligations read that: *"States Parties undertake to ensure and promote the full realization of all human rights and fundamental freedoms for all persons with disabilities without discrimination of any kind on the basis of disability"* and include:[558]

- *"To take all appropriate measures to eliminate discrimination on the basis of disability by any person, organization or private enterprise;*
- *To promote the training of professionals and staff working with persons with disabilities in the rights recognized in the present Convention so as to better provide the assistance and services guaranteed by those rights;*
- *To recognize that all persons are equal before and under the law and are entitled without any discrimination to the equal protection and equal benefit of the law;*
- *To prohibit all discrimination on the basis of disability and guarantee to persons with disabilities equal and effective legal protection against discrimination on all grounds;*
- *To take appropriate measures in order to ensure that private entities offer facilities and services take into account all aspects of accessibility for persons with disabilities (e.g. required training for staff, live assistance and intermediaries to facilitate accessibility and technologies and systems accessible)."*

*This leads to assessments elements 2 and 21.*

- **Management of consumer complaints**

In order to reduce consumers complaints, some international standards introduce guidelines that could be followed by financial institutions. One of the objectives of UN Guidelines for Consumer Protection is to promote the availability of effective consumer redress. In the scope of measures enabling consumers to obtain redress, three guidelines are defined: [559]

- *Governments should establish or maintain legal and/or administrative measures to enable consumers or, as appropriate, relevant organizations to obtain redress through formal or informal procedures that are expeditious, fair, inexpensive and accessible.*

- *Governments should encourage all enterprises to resolve consumer disputes in a fair, expeditious and informal manner, and to establish voluntary mechanisms, including advisory services and informal complaints procedures, which can provide assistance to consumers.*
- *Information on available redress and other dispute-resolving procedures should be made available to consumers.*

In March 2015, the Draft Resolution of the revision process of UN Guidelines for Consumer Protection established that member States should work towards establishing or encouraging "adequate complaints handling and redress mechanisms and policies which address, when relevant, sectorial and international specificities, technological developments and special needs of vulnerable groups."[560]

The OECD Guidelines for Multinational Enterprises on consumer interests (Chapter VIII) points out that enterprises should provide consumers with access to fair, easy to use, timely and effective non-judicial dispute resolution and redress mechanisms, without unnecessary cost or burden.[561]

In 2012, OECD also recognised the importance of complaints handling and redress on its G20 High-Level Principles. Principle 9 presents guidelines and effective approaches to complaints handling and redress such as: [562]

- **Complaint Handling and Redress Mechanisms**: Jurisdictions should ensure that consumers have access to adequate complaints handling and redress mechanisms that are accessible, affordable, independent, fair, accountable, timely and efficient. Such mechanisms should not impose unreasonable cost, delays or burdens on consumers.
- **Internal Complaints Handling**: In accordance with the above, financial services providers and authorised agents should have in place internal mechanisms for complaint handling and redress.
- **Alternative Dispute Resolution (ADR) Mechanisms**: Recourse to an independent redress process should be available to address complaints that are not efficiently resolved via the financial services providers and authorised agents' internal dispute resolution mechanisms.

On responsible lending, Consumers International (CI) states that, in order to ensure an accessible dispute resolution, companies should provide consumers' access to effective complaint mechanisms and dispute resolution.[563]

*This leads to assessments elements 3, 4, 5 and 6.*

- **Avoidance of over-indebtedness**

The United States subprime mortgage crisis in 2008 showed how the consequences of over-indebtedness are shared among all stakeholders of financial institutions. The European response with the Mortgage Credit Directive 2014/17/EU aims to create a Union-wide mortgage credit market with a high level of consumer protection. It applies to both secured credit and home loans. Member States will have to transpose its provisions into their national law by March 2016. [564]

The main provisions include consumer information requirements, principle based rules and standards for the performance of services (e.g. conduct of business obligations, competence and knowledge requirements for staff), a consumer creditworthiness assessment obligation, provisions on early repayment, provisions on foreign currency loans, provisions on tying practices, some high-level principles (e.g. those covering financial education, property valuation and arrears and foreclosures) and a passport for credit intermediaries who meet the admission requirements in their home member state.

The "fair treatment and proper disclosure", as recommended by the Draft Resolution of the revision on UN Guidelines for Consumer Protection also contributes to prevent over-indebtedness. Consumers need to be informed of loan conditions in order to be aware of their ability to repay.

This issue is also mentioned in the sixth principle of CI on responsible lending: *"Information should be provided in a manner to help the consumer make an informed choice".*[565] Two other principles are directly related to both prevent and manage over-indebtedness:

- *All lenders should make a proper assessment of a borrower's ability to repay (3)*
- *Debt resolution should be available for consumers who have become over-indebted (10)*

The G20 High-Level Principles on Financial Consumer Protection present two points that intend to prevent over-indebtedness, in line with its Principle 6 (Responsible Business Conduct of Financial Services Providers and Authorised Agents):

- **Best Interest**: Financial services providers and authorised agents should have as an objective, to work in the best interest of their customers and be responsible for upholding financial consumer protection
- **Assessing Consumer Needs**: Depending on the nature of the transaction and based on information primarily provided by customers, financial services providers should assess the related financial capabilities, situation and needs of their customers before agreeing to provide them with a product, advice or service.

*This leads to assessments elements 7, 8 and 16.*

- **Consumer safety**

Customers expect their financial institutions to ensure the safety of their money and the protection of their personal information. One of the objectives of UN Guidelines for Consumer Protection is to protect of consumers from hazards to their health and safety.

The OECD Guidelines for Multinational Enterprises on consumer interests highlight the importance of protecting personal data against consumer privacy violations, including security breaches. According to the guidelines, enterprises should:

- *Ensure that the goods and services they provide meet all agreed or legally required standards for consumer health and safety, including those pertaining to health warnings and safety information;*
- *Not make representations or omissions, nor engage in any other practices, that are deceptive, misleading, fraudulent or unfair; and*
- *Respect consumer privacy and take reasonable measures to ensure the security of personal data that they collect, store, process or disseminate.*

In Principle 8 of the High-Level Principles on Financial Consumer Protection, OECD claims that “Consumers’ financial and personal information should be protected through appropriate control and protection mechanisms. These mechanisms should define the purposes for which the data may be collected, processed, held, used and disclosed (especially to third parties). The mechanisms should also acknowledge the rights of consumers to be informed about data-sharing, to access data and to obtain the prompt correction and/or deletion of inaccurate, or unlawfully collected or processed data.”[566]

*This leads to assessments elements 10, 11, 12 and 13.*

### 4.1.3 Assessment elements

In addition to the documents and information sources commonly used in FFGI methodology, the consumer protection assessment uses as reference more specific documents of policies verification, giving preference to the official ones and sources recognized by the companies themselves, to minimize disputes and to maximize the objectivity of the analysis such as:

- Ombudsman Reports (ombudsman) of commercial banks (e.g. in Brazil, banks are required to send the report only to the Central Bank)
- Reports of consumers complaints at public consumer protection institutions (e.g. in Brazil main institutions are the Consumer and Protection Defense Departments and the National System of Consumer Information) and at the national monetary authority (e.g. Brazilian Central Bank)
- Annual Reports of financial institutions (data of consumer complaints, number of lawsuits etc.)

In order to ensure that consumer rights are respected, financial institutions should establish policies whose scope is consistent with its diversity of products and services. Therefore, the assessment elements will be scored for the following groups of financial products:

- **Current and saving accounts**: These are the most popular personal banking products that give to customers the flexibility of deposit and withdrawals.
- **Revolving credit**: Credit operations that encompass overdraft account, guaranteed account, revolving credit card and credit card with no interest owed. The amount involved in these operations is usually large, because they tend to repeat throughout the month.
- **Personal loans**: Loans that provide solutions to punctual needs and aspirations from consumers (e.g. payment of educational fees, auto loans and other consumption credits). The borrower is provided with a fixed amount to be repaid over a given period by a fixed number of instalments.
- **Mortgages**: Financing operations associated with the lending of savings deposits for building or purchasing residences. The loan is secured on the borrower's property.
- **Personal investment and insurance**: This group of products provides individual consumers access to fixed and variable income investments. It includes services related to pension funds, investment funds, capital stocks, government bonds and capitalization plans (usually offered by financial institutions as an investment product). In this scope, saving accounts are not considered.

To conclude, we list the elements that are crucial for a policy regarding the financial institution's relationship with customers.These aspects should be object of evaluation at a consumers’ protection financial institution policy:

1. The financial institution has a policy to disclose client's rights and the risks of products and services.
2. The financial institution has a policy that regulate staff ethics in serving clients in non-discriminatory way.
3. The financial institution ensures that consumers have access to adequate complaints handling and redress that have a due diligence process in place.
4. The financial institution discloses the results of complaints monitoring such as number of complaints, main issues, in which institutions/body for consumers defense the complaints where registered (direct or indirect ones), and from which channels they were received (call centre, website, e-mail, phone, bank branch).
5. The financial institution has public commitments to reduce consumer complaints, fixing goals to achieve and making this information accessible to any stakeholder.
6. The financial institution has Alternative Dispute Resolution (ADR) Mechanisms,- an independent redress process available to address complaints that are not efficiently resolved via the financial services providers and authorized agents' internal dispute resolution mechanisms such as Ombudsman.
7. The financial institution has a debt resolution policy available for consumers who have become over-indebted.
8. The financial institution has clear policies/ a code of conduct in order to protect consumers against over-indebtedness.
9. The financial institution has developed and implemented risk profiles with regard to investment products.
10. The financial institution respects client's private data protection (it does not disclose to other parties without client's consent).
11. Consumers' financial and personal information is protected through appropriate control and protection mechanisms with defined and published guidelines for which the data may be collected, processed, held, used and disclosed.
12. The financial institution has a policy and a clear procedure of accountability in case of robbery, theft and fraud involving customers in bank branches, ATM or internet and by its authorized agents.
13. The financial institution publishes its policies/procedures of debts collection and companies that represent them (third parties).
14. The financial institution has procedures and policies to avoid tie-in sales or inappropriate sales practices.
15. The financial institution provides consumers with key information that informs the consumer of the fundamental benefits, risks and terms of the product and changes in fees.
16. The financial institution has clear policies/a code of conduct on pre-contractual information regarding home loans.
17. The financial institution remuneration structure for staff of both financial services providers and authorized agents is designed to encourage responsible business conduct, fair treatment of consumers and to avoid conflicts of interest.
18. The financial institution has a program to properly train and qualify employees and authorized agents on consumer rights and protection policies and practices.
19. The financial institution has a program to properly train and qualify employees and authorized agents on products and services to consumers.
20. The financial institution monitors and discloses the average waiting time for customer services at bank branches and call centre and commits on disclosing public goal of maximum waiting time for customer services.
21. The financial institution has a policy committed to provide accessibility for customers with disabilities and special needs at all physical branches and electronic services, as at online platforms.

## 4.2 Financial inclusion

### 4.2.1 What is at stake?

Access to finance and credit to individual households provides the means to secure homes, invest in education and skills, get loans for health or medicines, bridge fluctuations in income generation and expenses, and start and expand businesses. In 2014, 2 billion people - or 38% of adults in the world - did not have access to basic financial services. Their ranks include more than half of adults in the poorest 40% of households in developing countries.[567]

Financial inclusion has become a burning issue related to the question about the contribution of finance to sustainable development. It has been seen as an instrument of poverty reduction, as well as a means to tackle inequality, that is significantly rising worldwide. There is a growing awareness that growth with inequality has its own limit and it cannot be sustained, because aggregate demand will be limited. If inequality is intolerably high, it will bring in a number of social consequences, at worst, social unrest, that will threaten economic growth and social stability.

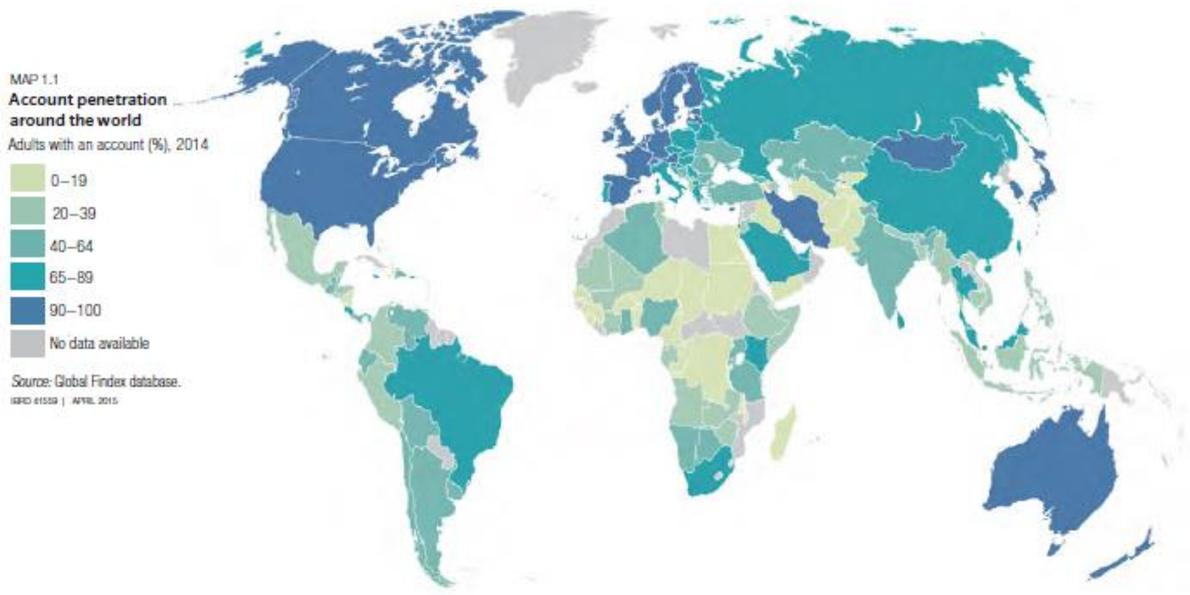
The history of financial services and institutions built to serve the poor and low income groups can be traced back in Europe's credit union movement in the 19th century and in modern time, paved by the success of Grameen Bank in providing microcredit to the poor Bangladeshi. At the same time, other Microcredit Financial Institutions (MFIs) mushroomed in providing similar credit to the low-segment clients in developing countries, mostly driven by social development purposes.[568]

Today, international organizations, including the G20 and the World Bank, have formulated strategies to promote financial inclusion. More than 50 countries have set formal targets and goals for financial inclusion. The World Bank set an ambitious goal to achieve Universal Financial Access (UFA) for working-age adults by 2020. The UFA 2020 goal envisions that adults worldwide will be able to have access to a bank account or electronic banking for savings and loans, sending payments and receiving income or remittances.[569]

Over the last years, the number of people with a bank account is growing fast. Between 2011 and 2014, the number of unbanked dropped by 20 percent. Innovations in technology, particularly mobile money, is an important driver for rapidly increasing access to financial services in Sub-Saharan Africa. Account ownership varies widely around the world. In high-income OECD economies, 94 percent of adults have a current and savings account, while in developing economies 54 percent of adults do. Among developing countries, the Middle East ranks the lowest (14 percent) and East Asia and the Pacific highest (69 percent). In Sub-Saharan Africa, 34 percent of adults have an account. See Figure 1 for an overview of account penetration around the world.

Apart from regional differences there is also a gender gap in financial inclusion. Globally, 65 percent of men had an account in 2014, while 58 percent of women did. In high-income OECD economies there is virtually no gender gap in account ownership. But in developing economies, while 59 percent of men had an account in 2014, only 50 percent of women did.[570]

## Figure 1 Account penetration around the world (2014)




Source: Demirguc-Kunt, A., et al. (2015, April), *The Global Findex Database 2014: The World Bank*, p. 12.

Also among the countries represented in the international Fair Finance Guide coalition, there are large difference in account penetration. The OECD countries that are part of the coalition have a penetration grade of nearly 100 percent, while in Indonesia one third of the population has a bank account. See Table 1 for figures on financial inclusion in Fair Finance Guide member countries.

## Table 1 Account penetration in FFG member countries (2014)

| | Share with an account | | |
|---|---|---|---|
| **Country** | All adults (%) | Women (%) | Adults in poorest 40% of households |
| Belgium | 98 | 100 | 98 |
| Brazil | 68 | 65 | 58 |
| France | 97 | 95 | 95 |
| Germany | 99 | 99 | 97 |
| Indonesia | 36 | 37 | 22 |
| Japan | 97 | 97 | 95 |
| Netherlands | 99 | 99 | 99 |
| Norway | 100 | 100 | 100 |
| Sweden | 100 | 100 | 99 |

Source: Demirguc-Kunt, A., et al. (2015, April), The Global Findex Database 2014: The World Bank, p. 83-84.

Micro, small, and medium enterprises (MSMEs) which have needs to access credit, face big challenges to access formal financial institutions. According to the International Finance Corporation's Enterprise Survey, 52 to 64 percent of formal microenterprises in developing economies are unserved or underserved. For small and medium enterprises, 55 to 68 percent of formal SMEs in developing economies are unserved or underserved.[571]

Financial inclusion is universal access, at a reasonable cost, to a wide range of financial services. The term financial inclusion is often used interchangeably with microfinance, and also confused with microcredit. The earlier practices of microfinance aimed to provide small loans to in particular vulnerable groups like women and poor families to enable them to escape indebtedness. However, soon it became clear that credit alone was not sufficient. There was a big demand for more diversified financial products and services offered by microfinance institutions (MFIs) such as saving and insurance. Therefore, we no longer speak of only microcredit or microfinance but of inclusive finance. Inclusive finance strives to enhance access to financial services for both individuals and micro-, small and medium-sized enterprises.[572]

To distinguish these terms, following are the working definitions (yet still evolving) of financial inclusion, microfinance and microcredit from recent literature:

- **Financial inclusion** (or **inclusive finance**) is a state in which everyone who can use them has access to a full suite of quality financial services, provided at affordable prices, in a convenient manner, with respect and dignity. Financial services are delivered by a range of providers, in a stable, competitive market to financially capable clients, including disabled, poor, and rural populations.[573] The Consultative Group to Assist the Poor defines financial inclusion as 'a state in which all working age adults, including those currently excluded by the financial system, have effective access to the financial services provided by formal institutions such as: credit, savings (defined broadly to include current accounts), payments, and insurance'.[574] The New Microfinance Handbook emphasises financial inclusion as a 'multidimensional, pro-client concept, encompassing increased access, better products and services, better-informed and -equipped consumers, and effective use of products and services'.[575]
- **Microfinance** is defined as diverse financial services (include credit, savings, insurance, remittances, money transfers, or leasing) provision for the low-income and poor. The services are expectedly being used for income generating, assets building, economic securities provision, and improving these low-segment clients' livelihood.[576]
- **Microcredit** is defined as a small amount of money loaned to a client by a financial institution. The specific characteristics of microcredit are group lending and the absence of collateral when borrowing.[577]

At the global level, financial inclusion has gained prominence on the sustainable development policy agenda. The United Nations World Summit for Social Development (WSSD) 1995 recognised access to credit and financial services as a tool for poverty alleviation. Poverty alleviation was one of the three main themes at the summit (others are productive employment and social integration).[578] Leaders of the G8 and G20 recognize the importance of financial inclusion to their economies. This has been legitimized in their meetings in Pittsburgh (2009) and Seoul (2010), which mandated a Global Partnership for Financial Inclusion (GPFI).[579] At the G20 Summit in Toronto, June 2010, G20 countries signed the Toronto Declaration on Principles for Innovative Financial Inclusion.[580]

Moreover, the Bank of International Settlements, based in Basel, Switzerland, and other standard setting bodies have addressed the regulatory and standardized aspects of financial inclusion.[581] When business leaders, head of states and governments, as well as representatives from academia, development organizations, non-profits and media gathered for the World Economic Forum in Davos, Switzerland, January 2014, they also brought up the issue of financial inclusion and inclusive growth at the centre of the agenda.[582]

As an international development agenda, there has been subtle shift from the concept of microfinance to financial inclusion which covers a broader aspect than microfinance does. While financial inclusion keeps the ‘development objective’ i.e. to pave the way for the poor to escape poverty, the ‘inclusion’ aspect of such term aims to cover not just the poor but also the near poor or even the middle class, in general, to increase the penetration of financial services to the whole population.

Nonetheless, that broader definition of financial inclusion also poses some risks. It is because banks, although they are not the only financial institution actors for financial inclusion, on the one hand might be pressured by their state government to provide microcredit to small enterprises and poor people, on the other hand, might see this as an opportunity to expand their credit market to broader groups of population. Such expansion might lead to financial liberalisation and commercialisation of credits. Other challenges for banks are the profitability and risks incurred by the provision of financial services and products to yet excluded clients.[583]

Broader access to finance might also bring about risks to the clients. For instance, banks might use the previously excluded clients’ savings or remittances to be invested in something with risks the clients have no information about or the clients might be offered products or services with risks they have no knowledge about. These risks are due to the problems in the financial market: asymmetrical information, low quality of information, financial sector infrastructure and due to low level of financial literacy and capability. These problems are faced by not just clients in the low income countries but also in middle and high income economies. Lessons learned from the financial crisis - cases of predatory lending, subprime mortgages and other financial misconduct involving consumers - indicate that there is a need for re-emphasizing a top-down and bottom-up ethical approach for the financial sector while improving access to remedy and ensuring protection for consumers, even in the financial inclusion agenda.[584] The importance of consumer protection in financial markets and a methodology to assess the policies of financial institutions regarding consumer protection is further explained in section 4.1

While the aspect of governance and regulation is important in financial inclusion, at the same time it is important to keep financial providers like banks attracted to serve the financially excluded clients, despite the higher risks and lower profit. According to the New Microfinance Handbook (2013), balancing clients’ interests and providers’ viability, financial inclusion incorporates effective policies, legislation, industry and consumer protection standards, and financial capability.[585]

Hence the inclusion of the excluded, unbanked and underserved people and SMEs will contribute significantly to global poverty reduction. At the national level, it is the role of the government as regulator and facilitator, especially to develop related policies and an enabling infrastructure.[586] Financial institutions can play a vital role in providing access to finance to all income groups in a society. The next section gives an overview of international standards with regard to financial inclusion, which serve as a basis for policies by individual financial institutions.

### 4.2.2 International standards

Most of the international principles and standards pertaining to financial inclusion are voluntary, and introduced mostly by, so far, groups of countries like G8 or G20. Representing two-thirds of the world's population, the latter have been more active in drawing principles and standards, understandably due to the relevancy of financial inclusion to the low access of their massive population to formal financial services. Also dedicated organisations as the Center for Financial Inclusion (CFI) are involved in setting targets and principles regarding financial inclusion. Moreover, the United Nations Environmental Programme (UNEP) links financial inclusion with the realisation of human rights.[587]

In this sub-section, we first list the major international initiatives and standards regarding inclusive finance. As a next step, a set of indicators will be provided to assess the financial inclusion policies of financial institutions.

- **Key Principles of Microfinance**

  The Consultative Group to Assist the Poor (CGAP), housed at the World Bank, is a global partnership to advance financial inclusion. According to CGAP, being included in the formal financial system helps people to:

  - Make day-to-day transactions, including sending and receiving money;
  - Safeguard savings, which can help households manage cash flow spikes, smooth consumption and build working capital;
  - Finance small businesses or microenterprises, helping owners invest in assets and grow their businesses;
  - Plan and pay for recurring expenses, such as school fees;
  - Mitigate shocks and manage expenses related to unexpected events such as medical emergencies, a death in the family, theft, or natural disasters; and
  - Improve their overall welfare.[588]

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  CGAP developed 11 Key Principles of Microfinance that were endorsed by the G8 summit in 2004.[589]

- **G20 Financial Inclusion Action Plan**

  The Global Partnership for Financial Inclusion (GPFI) is a platform for all G20 countries, interested non-G20 countries and relevant stakeholders to carry forward work on financial inclusion, including implementation of the G20 Financial Inclusion Action Plan (FIAP), endorsed at the G20 Summit in Seoul in 2010 and updated in 2014. Along with the FIAP, GPFI developed a set of financial inclusion indicators, measuring financial inclusion in three dimensions:[590]

  - Access to financial services;
  - Usage of financial services; and
  - The quality of the products and the service delivery.

- **The Seven Principles For Investors In Inclusive Finance**

  The Seven Principles for Investors in Inclusive Finance (PIIF) are aligned with the UN-backed Principles for Responsible Investment (PRI) and provide investors with specific guidance on responsible investment in inclusive finance. According to the PRI, "investors are looking at ways to contribute to economic development and entrepreneurial activity by investing in inclusive finance. As with all investments, these can also carry potential financial and reputational risks." To mitigate such risks, a group of institutional investors launched the PIIF in 2011.[591]

- **Maya Declaration on Financial Inclusion**

  The Maya Declaration on Financial Inclusion of the Alliance for Financial Inclusion (AFI) covers four areas, which are aligned with the G20 Principles for Innovative Financial Inclusion:[592]

  - Create an enabling environment to harness new technology that increases access and lowers costs of financial services;
  - Implement a proportional framework that advances synergies in financial inclusion, integrity, and stability;
  - Integrate consumer protection and empowerment as a key pillar of financial inclusion;
  - Utilize data for informed policymaking and tracking results.

- **Financial Inclusion 2020: The Roadmap Principles**

  The Center for Financial Inclusion identifies five priority focus areas that are key to achieving financial inclusion. The Financial Inclusion 2020 Roadmap Principles are:

  - Addressing customer needs;
  - Technology-enabled business models;
  - Financial capability;
  - Client protection;
  - Credit reporting.

- **UNEP Inquiry on the Design of a Sustainable Financial System**

  A premise of the UNEP Inquiry on the Design of a Sustainable Financial System is that a bold new vision is needed to put the world on a sustainable path. The financial system is the lifeblood of the economy at the local, national, and global level. As such, it has an important positive role to play in supporting poverty alleviation efforts and the realization of human rights. However, inherent conflicts of interest that can result from profit-seeking financial institutions running financial inclusion need to be addressed through appropriate safeguards.[593]

Drawing from these principles, following are some criteria and indicators to cover the main aspects of financial inclusion:

- **Access of low-income and other marginal groups to financial services**

  Access to financial services is the first dimension to measure financial inclusion according to the G20 Financial Inclusion Indicators developed by the GPFI (Global Partnership for Financial Inclusion).

  The Key Principles of Microfinance state that “access to sustainable financial services enables the poor to increase incomes, build assets, and reduce their vulnerability to external shocks. Microfinance allows poor households to move from everyday survival to planning for the future, investing in better nutrition, improved living conditions, and children’s health and education.” The principles also mention that ”interest rate ceilings can damage poor people’s access to financial services” reminding financial institutions to keep their interest rates at bay; otherwise it would potentially damage poor people’s access to financial services.[594]

In October 2013, 300 people (leaders from the mainstream and specialized financial sectors, technology providers and the corporate sector, international non-profits, public policymakers, representatives of specific client segments such as women, persons with disabilities, elderly, youth, rural, refugees, and consumer advocates) participated in the Financial Inclusion 2020 Global Forum to raise awareness of their unique needs and assets. FI2020 Roadmap to Inclusion Principle 2 is promoting the use of enabling technology such as branchless banking and mobile banking to accelerate the access of people who live in the areas where financial infrastructure is too poor and does not allow them to access financial services physically. Physical access is usually measured through the broad of coverage of bank branches (outside mainstream big cities) and service points.[595]

The Principles of Investors in Inclusive Finance encourage retail providers to expand their range of financial services available to low-income populations (e.g. savings, loans, insurance, payment services, remittance facilities and pension plans) and to more remote areas and more vulnerable populations.

The first focus area in the Maya Declaration on Financial Inclusion is to ‘create an enabling environment to harness new technology that increases access and lowers costs of financial services (include promotion of mobile financial services to lower the cost of services)’.

*This leads to assessment element 1, 2, 3, 4, 5.*

- **Financial capability of clients**

  Often, poor people and marginal groups that are the target of financial services and microfinance have no prior knowledge and sufficient financial literacy to understand the products and services offered to them be they loans, credit, insurance or savings. The G20 Principles for Innovative Financial Inclusion, encourage financial institutions to develop financial literacy, financial capability and adequate redress mechanisms to make sure that their clients are aware of what they are up to by agreeing to saving scheme, loan scheme, credit scheme or insurance scheme.

  This is more apparent in the case of the developing countries where low levels of literacy, not to mention financial literacy, is still widespread. Lack of financial capability caused a significant barrier to accessing and properly using of financial services. Therefore, increased financial literacy and capability will in turn increase demands for more transparent and better service from the financial institution.

  FI2020 Roadmap to Inclusion focuses on empowering clients to know their rights as consumers, and have the skills, attitudes, aspirations, and confidence to exercise those rights. Principle 1 broadens the term to financial capability, which is an effort to encourage sound financial choices and behaviour by customers. Increasing financial capability means financial institution must promote measures to enable clients to have knowledge, skills, attitudes and behaviour needed to make sound financial decision.

  *This leads to assessment element 6, 7 and 8.*

- **Affordability and quality of products and services**

  The poor need a variety of financial services, not just loans, but also savings, cash transfers, and insurance, according to the Key Principles of Microfinance. The principles also underscore the need for financial institutions to promote product and service diversity and innovation. For instance, in more recent development, specific service such as to assist migrant workers to manage remittances is also expected to be provided by financial institution.

  Financial institutions must make the effort to reduce transaction costs and offer products and services that meet clients' needs and also provide services that are convenient, flexible, and reasonably priced. The Principles of Investors in Inclusive Finance recommend financial institutions to provide a broad range of services to low-income clients, and develop innovative products tailored to their needs.

  G20 Financial Inclusion Indicators describe indicators for cost of usage - average cost of opening a basic current account, average cost of maintaining a basic bank current account (annual fees), and average cost of credit transfers – and credit barriers - tightness of credit conditions (requirement for SMEs to provide collateral to get loan), getting credit: distance to service points. Overall, quality of products and services can be measured through price, cost, time as well as criteria and requirement (e.g. collateral).

  The EU Payment Accounts Directive requires member states to provide access to a basic payment account from 2016. Some banks have already started to implement the directive. In order to ensure that payment accounts with basic features are available to the widest possible range of consumers; they should be offered free of charge or for a reasonable fee.[596]

  *This leads to assessment element 9, 10, 11, 12 and 13.*

- **Consumer/client protection**

  Consumer protection is more apparent in financial inclusion because the subject of protection are most likely the poor, illiterate and therefore have no knowledge at all to any kind of information or grieving mechanism offered (or not) by the financial institution. The Client Protection Principles for Microfinance, endorsed by providers of financial services, networks and individuals working in microfinance, describes the minimum protection microfinance clients should expect from providers. The principles cover:

  - avoidance of over-indebtedness
  - transparent pricing
  - appropriate collection practices
  - ethical staff behaviour
  - mechanism of redress of grievances
  - privacy of client data

  Parties endorsing these principles are the providers of financial services, networks and individuals working in microfinance. As of November 2010, more than 100 investment organizations have endorsed the Principles and are taking concrete actions to encourage providers to adopt appropriate client protection policies and practices.

  Maya Declaration on Financial Inclusion suggests an integration of consumer protection and empowerment as a key pillar of financial inclusion as one of its four broad areas that 'has been proven to increase financial inclusion' and in line with the G20 Principles for Innovative Financial Inclusion.

The FI2020 Roadmap to Inclusion emphasize on client needs and consumer protection i.e. addressing client needs, credit reporting and consumer protection. This roadmap sets in the explanation on client protection that financial inclusion with client protection will occur when all clients can affirm the following five statements:

- I have a choice of quality and affordable financial services.
- I can get information I need and understand it to make an informed decision.
- I have confidence in my provider, am treated with respect and am not discriminated against.
- I understand the risks involved in using financial services and believe they are offset by the benefits I gain.
- I know my rights and where to complain when problems arise.

Based on the OECD standard on consumer protection, G20 countries also endorsed the G20 High-level Principles on Financial Consumer Protection, that encompass the following 10 topics:

1. Legal, Regulatory and Supervisory Framework
2. Role of Oversight Bodies
3. Equitable and Fair Treatment of Consumers
4. Disclosure and Transparency
5. Financial Education and Awareness
6. Responsible Business Conduct of Financial Services Providers and Authorised Agents
7. Protection of Consumer Assets against Fraud and Misuse
8. Protection of Consumer Data and Privacy
9. Complaints Handling and redress
10. Competition

The UN PRI has developed the Principles of Investors in Inclusive Finance. These principles recommend financial institutions to integrate client protection into their investment policies and practices, promoting the principle to their suppliers and to report the progress to their investor and stakeholders. The principles also highlight the importance of financial institutions to treat the low-income clients fairly.

*The assessment elements of this topic are part of the theme Consumer protection.*

### 4.2.3 Assessment elements

There are three important actors in financial inclusion: the regulator (government), the financial institutions and the clients. The elements of a good operational policy on financial inclusion here cover two sides, namely the clients, which are individuals and MSMEs[xxii], and the financial institution, which is in most cases, a bank. Due to aim of the Fair Finance Guide International in this assessment are no elements included regarding responsibilities of governments.

In order to ensure that financial inclusion for low-income target groups is guaranteed, financial institutions should establish policies whose scope is consistent with its diversity of products and services. The the assessment elements will be scored for the same groups of financial products as in the theme Consumer protection:

[xxii] For the purpose of the study microenterprises are defined as those with 1 to 4 employees; very small, 5 to 9 employees; small, 10 to 49 employees; and medium, 50 to 250 employees, based on IFC Advisory Services | Access to Finance (2013, August), *Access to Credit Among Micro, Small, And Medium Enterprises*, International Finance Corporation World Bank Group, p. 4.

- **Current and saving accounts:** These are the most popular personal banking products that give to customers the flexibility of deposit and withdrawals.
- **Revolving credit:** Credit operations that encompass overdraft account, guaranteed account, revolving credit card and credit card with no interest owed. The amount involved in these operations is usually large, because they tend to repeat throughout the month.
- **Personal loans:** Loans that provide solutions to punctual needs and aspirations from consumers (e.g. payment of educational fees, auto loans and other consumption credits). The borrower is provided with a fixed amount to be repaid over a given period by a fixed number of instalments.
- **Mortgages:** Financing operations associated with the lending of savings deposits for building or purchasing residences. The loan is secured on the borrower's property.
- **Personal investment and insurance:** This group of products provides individual consumers access to fixed and variable income investments. It includes services related to pension funds, investment funds, capital stocks, government bonds and capitalization plans (usually offered by financial institutions as an investment product). In this scope, saving accounts are not considered.

Sources for analysis are annual reports, website information, brochures, advertisements and community outreach programmes. The following elements are crucial for a policy regarding the financial institution's internal operations:

1. The financial institution has policies, services and products that specifically target the poor and marginal groups.
2. The financial institution has branches in rural areas, not only in cities.
3. The financial institution provides branchless, cashless (e-money) and mobile banking services.
4. The financial institution’s share of loans channelled to MSMEs is above 10%.
5. The financial institution does not require collateral for MSMEs to borrow.
6. The financial institution has a policy to disclose client’s rights, and risks of product or service (including risk of over indebtedness) offered to low-literate clients and MSMEs.
7. The financial institution’s terms and conditions is available to clients in national/local language.
8. The financial institution has a policy to improve financial literacy of low-income, marginal groups and MSMEs.
9. The financial institution does not charge clients to open a basic bank account or for a reasonable fee.
10. The financial institution does not require a minimum balance for maintaining a basic bank account.
11. The financial institution has a standard and provides information on credit processing time.
12. The financial institution has appropriate, affordable, and convenient financial products to send or receive domestic remittances through an account.
13. The financial institution provides low-income housing finance.

## 4.3 Remuneration

### 4.3.1 What is at stake?

Remuneration for employees within a company increasingly consists of a fixed part - the base salary - and a variable part. The height of this variable part can be determined in different ways, for example by linking the achievements of the employee to the financial result of (a part of) the company. In case of good achievements or good financial results, the variable remuneration for the employee can be relatively high compared to the base salary, but the reverse can also occur. The variable remuneration part is often referred to in terms of bonus, commission pay, profit sharing, performance remuneration, etc. In this paper all these variable types of remuneration are called "bonuses".

Granting bonuses does not necessarily have to be a bad thing. It is often viewed as an 'honest' way of repaying exceptional efforts. Some also regard a bonus system as a way to encourage companies to become more sustainable.[597] However, there are negative aspects to consider as well.

Firstly, in practice, bonuses are regularly linked to indicators in which the importance of the enterprise as a whole is not reflected and certainly not the wider social importance. In these cases, the indicators are aimed too much towards short term objectives, on financial results and on the achievements of the individual employee, while achievements coming from long term objectives and the non-financial results of the company as a whole would be better indicators. If these are left out of the equation, employees can be encouraged to take undesired and sometimes irresponsible risks that may be of personal importance, but are not of importance to the company and society, with all their respective consequences.

Secondly, the often very large bonus sums leads to a lot of social indignation as the link between personal strains, the financial achievements of the company and the height of the bonus seems lost. Top managers receiving huge salaries and bonuses whilst the enterprise they work for suffers financial difficulty and even has to fire people, is incomprehensible to a lot of people. The same applies to top managers of financial institutions.

The short-term objectives and the excessive sums - characterise the bonus culture in the US, UK, and other financial institutions, mainly in the investment banking departments. Many people consider this bonus culture in the financial world to be one of the main causes of the current financial crisis.[598] The prospects of a very high bonus - based on short-term financial objectives - lead to granting mortgages and loans to people that could not really afford them. The consequences of this risky behaviour have been felt globally:

- Consumers are insufficiently informed of the risks of the products that were sold to them. Particularly in the United States this has led to a lot of people being evicted from their homes because they could no longer afford to pay their mortgages and loans;
- A part of the receivables that financial institutions had on consumers could therefore not be resold, causing financial problems for the financial institutions themselves, but also for the rest of the financial system to which outstanding receivables had been sold;
- Society has had to save financial institutions from bankruptcy and partly due to this was faced with an economic crisis;
- Not only the countries of origin of the financial institutions, but also developing countries are experiencing the negative consequences of this economic crisis in decreased export revenues, foreign investments, currency exchange rates and budgets for development aid.[599] Estimates of several organisations on the number of people that have fallen, and will fall, into poverty through the financial crisis are running into tens of millions.[600]

Due to these developments, the public and governments have frequently called for the mitigation of bonuses, for a link to long-term objectives, or for the entire abrogation of bonuses, mainly in the financial world.

On average, the number of companies that have included sustainable objectives in their bonus policy is one third. This has arisen from an analysis of the annual reports of the largest listed companies in eleven countries. The objectives are related to environmental issues (reduction of emissions and energy efficiency) and social issues (client satisfaction, safety, social involvement, employees). Research also shows that the companies are convinced that including sustainable criteria in their remuneration policy contributes to more sustainable development.[601] CEOs of multinational corporations also consider this an important method in developing a new and sustainable vision of the corporate world.[602]

Due to the increased attention to the height of bonuses and the link with sustainability and Corporate Social Responsibility, all financial institutions should develop solid bonus policies. To this effect, financial institutions can make use of the international standards and initiatives described in the following section.

### 4.3.2 International standards

As far as regulation and standards concerning remuneration are concerned, there are currently no global policies in place.

In the United States, regulators have implemented mechanisms to supervise remuneration paid by banks to their employees, which are mandated by § 956 of the Dodd-Frank Wall Street Reform and Consumer Protection Act. Banking regulators have specifically targeted bank practices regarding incentive-based compensation. In undertaking this initiative, the banking regulators have jointly implemented a variety of regulatory regimes.

In the United States, three Federal Statutes are relevant in relation to remuneration: [603]

- Sarbanes-Oxley Act of 2002 (SOA) §304; 15 U.S.C. §7243(a)
- Emergency Economic Stabilization Act of 2008 (EESA) §111(b)(3)(B), as added by Section 7001 of the American Recovery and Reinvestment Act of 2009 (ARRA); 12 U.S.C. §5221(b)(3)(B) (applicable only to recipients of assistance under the Troubled Asset Relief Program (TARP) that have not repaid the Treasury)
- Dodd-Frank Wall Street Reform and Consumer Protection Act (DFA) §954, 15 U.S.C. §78j-4(b)

In the European Union, the European Banking Authority (EBA) has set out requirements in the Capital Requirements Directive (CRD). There are three main Directives that regulate remuneration: [604]

- Capital Requirements Directive IV (CRD IV) and CRD II
- Alternative Investment Fund Managers Directive (AIFMD)
- fifth Undertakings for Collective Investment in Transferable Securities Directive (UCITS V)

The CRD IV and the Capital Requirements Regulation (CRR) both came into force on the first of January 2014 and essentially carried over the existing provisions of the CRD III relating to remuneration with some enhancements in relation to the bonus cap. The relevant provisions can be found in articles 74, 92 to 95 and 161 (in addition to recitals 62 to 69 and 83) in the CRD IV; and in article 450 on disclosure in the CRR.[605]

In July 2010, the European Parliament achieved an agreement on a new European guideline that establishes stringent norms for the bonuses paid out by banks. A maximum of 30% of the total bonus may be paid out in *cash*, for very large bonus there is even a maximum of 20%. The payment of 40 to 60% of the bonus has to be deferred over a period of at least three years so the bonus can be recovered if the results prove to be disappointing at a later stage. At least 50% of the bonus has to be paid out as subordinated capital: funds on which the bank can first make recourse should the bank get into trouble. Finally, the ratio between bonus and fixed salary is also kept to a maximum, but the guideline does not provide to which maximum. The guideline is binding for all banks in the European Union and came into force on 1 January 2011.[606]

The Committee of European Banking Supervisors released an elaboration of the principles in these European guidelines in December 2010, the Guidelines on Remuneration Policies and Practices. In March 2013 the European Parliament proposed new regulations for the remuneration in the financial sector. The adjusted motion has been adopted in April 2013. As of January 2014 it is no longer allowed to pay out bonuses of more than 250% of the annual salary.[607]

The European Banking Authority (EBA) has also published various Regulatory Technical Standards (RTS) for the definition of material risk takers, and for remuneration purposes set out process and criteria for the identification of staff who have an impact on the institution's risk profile, so-called 'Identified Staff'.[608]

The Financial Stability Board (FSB) - previously the Financial Stability Forum (FSF) - was established in 1999 by the G7[xxiii] with the objective of improving international financial stability. In the FSB central banks, financial supervisors and financial institutions are represented.

In response to the international financial crisis in April 2008, the FSB issued a report with recommendations to improve the strength of financial markets and institutions. One of these recommendations was to reduce the risks associated with the remuneration policy. For this purpose, end 2008 a Compensation Workstream Group was formed with the mandate to establish sound principles, which resulted in the Principles for Sound Compensation Practices. The emphasis of these principles is on the relation between the degree of risk that an employee takes on behalf of the company and the height of the remuneration that is granted. In practice, this means that if two employees realise the same amount of profit, but have taken various levels of risk, they should not receive similar compensation. Therefore, the remuneration is corrected downwards if more risk has been taken.

Other standards, reports and guidelines to consider are the UN PRI and Global Compact's recommendations on remuneration; the G20's recommendations about remuneration at the Pittsburgh Summit in 2009; Consumers International's report Responsible Lending (2013), and the 2010 Sustainable Remuneration research report of Association of Investors for Sustainable Development (VBDO), the Hay Group, and DHV, which serves as a manual to link sustainability objectives to the bonus of company managers.

In terms of regulating remuneration in the financial sector, a relevant remuneration policy mainly concerns measures that are aimed at tackling risky behaviour as well as short-term strategies and goals within the financial sector, thereby increasing stability, transparency and accountability in the financial system, and includes the following topics:

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[xxiii] The G7 consists of the Ministers of Finance of seven industrialised countries (Canada, Germany, France, Great-Britain, Italy, Japan, and the United States) and they meet annually to discuss economic and financial issues. Since Russia became a member the group is called the G8.

- **Clawback schemes**

In its 2009 report the Financial Stability Board (FSB) states that compensation payout must be sensitive to the time horizon of risks. This means that if a bonus is granted that is sensitive to risk outcomes, it should be seen as a multi-year risk horizon. Otherwise employees could have an incentive to expose the firm to risks that are unlikely to be exposed for some time. To align time horizons a bonus can be subjected to a clawback. In United States legislation "clawback" means a repayment of previously received compensation required to be made by an executive to his or her employer. Clawbacks under SOA §304 concern only clawbacks from the CEO and the CFO and apply only to cases in which there is "misconduct" resulting in "material noncompliance of the issuer…with any financial reporting requirement under the securities laws….".

The EESA of 2008 only applies to institutions receiving aid under the Troubled Asset Relief Program (TARP) and requires that institutions that are receiving assistance under TARP are obligated to maintain certain standards for executive compensation and corporate governance.[609] Under the Dodd-Frank Act §954 (DFA), publicly traded firms are obligated to have policies in place that enforce the repayment of specific types of overpayments made to executives, based on financial results that turn out to be false and require a restatement.[610] The clawback is to be carried out if the listed company is required to file a financial restatement under securities laws due to material noncompliance under those laws. The clawback applies to "incentive-based compensation (including stock options awarded as compensation) during the 3-year period preceding the date on which the issuer is required to prepare an accounting restatement, based on the erroneous data, in excess of what would have been paid to the executive officer under the accounting restatement."[611]

In the European Union, malus or clawback arrangements are explicit ex-post risk adjustment mechanisms where the institution itself adjusts remuneration of a staff member based on such mechanisms (e.g. by lowering awarded cash remuneration or by reducing the number or value of instruments awarded).The CRD IV pertains to banks and other financial institutions and the clawback arrangements dictate that up to 100% of variable pay will be subject to clawback or malus arrangements. Financial institutions will be required to set specific criteria for such arrangements.[612]

*This leads to assessment element 1.*

- **Bonus maximum**

In the United States, a maximum for bonuses or variable remuneration is officially regulated through the DFA § 956, however the language of the Act is not quantified sufficiently.[613] For example, the banking, securities and federal housing regulators have proposed regulations (Proposed Regulations) that state that financial institutions are prohibited "from having incentive—based compensation arrangements that may encourage inappropriate risks (a) by providing excessive compensation or (b) that could lead to material financial loss to the covered financial institution." However, no standards have been created to give these ambiguous regulations substance. Nevertheless, the regulators have claimed that such standards will be established.[614]

In the European Union, under the CRD IV "variable pay" or a maximum for bonuses is capped at 100% of total fixed pay or, with shareholder approval, 200% of total fixed pay. This is including performance based payments or benefits and, in exceptional circumstances, other contractual elements that do not "*form part of a routine employment package*" (examples in the Directive include healthcare, child care facilities or proportionate regular pension contributions). EU Member States have the discretion to adopt stricter standards (e.g. lower bonus caps).[615]

The Netherlands implemented regulation in 2013, which does not allow bonuses within the finance sector above 20% of fixed remuneration.[616] With regard to normalising the variable remunerations, the Dutch labour union confederation FNV advised that the height of the variable remunerations when compared to the fixed wage, meaning the total remuneration, has to be restricted. In this respect, FNV strives for a maximum bonus of 10% of the fixed remuneration for both staff that fall under a collective agreement as well as the top management. Therefore, the total income for top managers is a maximum of twenty times the lowest salary in the company plus 10% of this amount.

*This leads to assessment elements 2, 3 and 4.*

- **Highest versus lowest salaries**

The Dodd-Frank Act Section 953 requires proxy disclosure of median employees (as calculated under the SEC's executive compensation disclosure rules) to CEO pay.

In the Netherlands, the Dutch labour union confederation FNV believes that it is important that a norm is pursued for the ratio between the fixed wage for the top and the fixed remuneration for staff that fall under a collective agreement. This norm can be related to various anchor points, but FNV establishes this norm at a maximum of twenty times the lowest salary within the company or twenty times the maximum of the lowest salary scale.

*This leads to assessment element 5.*

- **Long-term objectives**

Another criterion to consider for sound remuneration policies, is that of long-term objectives for investment practices. When granting variable remuneration as a reward for certain achievements, it is important to consider whether the achievements concern long-term or short-term objectives, for the company itself and for society at large. This can also be accomplished through clawback schemes.

The G20[xxiv] had established that restructuring policy and practice on remunerations and bonuses is required to further support financial stability. As a part of their recommendations, at the Pittsburgh Summit in September 2009, the G20 agreed that it is necessary that a significant part of variable remunerations has to be linked to achievements and creating long term value. The G20 encourages companies to implement their agreements with immediate effect.

In the United States, the Federal Reserve in cooperation with other banking agencies in 2010 issued Final Guidance on Sound Incentive Compensation Policies, in which it is stated that "incentive compensation arrangements at banking organizations [should] appropriately tie rewards to longer-term performance." [617]

In the European Union, regulation (CRD IV/ RTS) is aimed at stimulating a focus on long-term objectives, instead of rewarding risky activities that would offer profit in the short term. In the EBAs Guidelines on Sound Remuneration Policies, it is stated that "To set the appropriate incentives for long-term oriented and prudent risk taking, the remuneration policy and practices need to be transparent on the fixed remuneration, the variable remuneration and award criteria. Fixed remuneration should be permanent, predetermined, nondiscretionary and non-revocable." [618]

[xxiv] The G20 consists of the 19 countries that have the largest national economies and the European Union. They meet annually or more often if needed to discuss the international financial system.

In cooperation with the UN Global Compact, the UN PRI has made recommendations on taking up ESG criteria in the variable rewards of the employees - Integrating ESG issues into executive pay. In order to make the senior employees more aware of ESG issues, these two initiatives recommend companies to develop mechanisms that ensure that both the company's interest as well as the employee's and society's interest are connected to one another. This may be done by setting long-term goals for employees as well as the company.

In the Netherlands, the Dutch Association of Investors for Sustainable Development (VBDO), Hay Group and DHV call upon all companies to base at least 60% of the bonus on long-term objectives. To achieve this it is important to take the activities and the industry in which a company operates into account. According to the VBDO, Hay Group and DHV, sustainable objectives for banks should comprise of: integrity, responsible investment and the level of energy consumption. In the report, sustainability is defined as the total of all organisation specific issues with an ethical, environmental and/or social nature that influence the interests of the organisation and its stakeholders. Within this framework, a company that, besides the financial objectives, aims towards client satisfaction is considered as a company with a limited sustainable focus. A company that in addition also aims for employee satisfaction and the reduction of its $CO_2$-emissions is considered to be more sustainable.

*This leads to assessment element 6.*

- **Non-financial criteria**

The International Labour Organisation emphasises in its World of Work Report 2013 that it is important to increase a focus on better alignment of the activities in the financial sector with the needs of the real economy, for example through linking performance-based compensation to social and environmental objectives.

In the UN Global Compact and UN PRI report *Integrating ESG issues into executive pay* companies are recommended to link appropriate ESG metrics to reward systems in a way that they form a meaningful component of the overall remuneration framework. They are furthermore encouraged to develop their own definition of sustainable value creation and use it to select appropriate ESG metrics, thereby also consulting shareholders and stakeholders in order to enhance internal and external support.

In the European Union, the CRD Remuneration requirements: Articles 74 and 92 to 96 and Article 450 CRR dictate that remuneration that is linked to performance, should in total be based on both the assessment of the performance of an individual, the business unit concerned and the overall results of the institution. When assessing the performance of an individual, financial as well as non-financial criteria are to be taken into account. The total amount of remuneration is based on a combination of the assessment.

In the Netherlands, the Dutch Association of Investors for Sustainable Development (VBDO), Hay Group and DHV call upon all companies to base at least one third of the total bonus on sustainable objectives. To achieve this it is important to take the activities and the industry in which a company operates into account. According to the VBDO, Hay Group and DHV, sustainable objectives for banks should comprise of: integrity, responsible investment and the level of energy consumption. Also the Dutch labour union FNV argues that for top positions the criteria for variable remuneration should be aimed at sustainability with respect to social policy, the environment and client focus. The Dutch law on the remuneration policies of financial institutions makes it mandatory to base at least 50% of the variable remuneration on non-financial criteria.

The Dutch Banking Code provides that, besides financial achievement criteria, non-financial achievement criteria also have to be an important part of an assessment of an individual for variable remuneration. In its recommendations, the Maas Committee gave examples for these non-financial criteria, such as client satisfaction, risk management, investor relations, operational objectives, human resources, integrity, compliance and sustainability.

*This leads to assessment element 7, 8, 9, 10, 11 and 12.*

### 4.3.3 Assessment elements

All forms of variable remuneration are considered a bonus. This includes profit sharing programs, except those that cover all employees and at equal terms. The ideal bonus policy would be extremely sober, in part based on sustainability criteria and would also include the possibility of recovering the bonus in cases of malpractice. Banks and financial institutions should not make exceptions in their bonus policies for investment bankers or subsidiaries.

A solid policy for the entire financial institution (including all subsidiaries) on remuneration at least concerns the Board of Directors, the directors (in case of a 2-tier board structure), the senior management and risk takers. The senior management includes the people that are ultimately responsible for certain divisions, portfolios, internal departments, etc. that operate directly under the directors and Board of Directors. Risk takers comprise of investment bankers, stock exchange traders and trading room managers. Each element (with the exception of elements 1, 5 and 6) will be scored for these three groups. The FFG’s expectations on remuneration policies therefore only concern the financial institutions’ employees which are not covered by a collective labour agreement.

The following elements are crucial for a policy regarding the financial institution's internal operations:

1. The financial institution maintains the right to recover bonuses if, after payment, it appears that they were paid unduly (a so-called *clawback* scheme).
2. The bonus is a maximum of 100% of the fixed annual salary.
3. The bonus is a maximum of 20% of the fixed annual salary.
4. The bonus is a maximum of 10% of the fixed annual salary.
5. The fixed salary does not exceed twenty times the lowest salary or the maximum of the lowest salary scale within the financial institution.
6. At least 60% of the bonus is based on long term objectives (not to be confused with agreements for deferred payment of the bonus).
7. At least one third of the bonus is based on non-financial criteria.
8. At least two third of the bonus is based on non-financial criteria.
9. The bonus is based on employee satisfaction.
10. The bonus is based on client satisfaction.
11. The bonus is based on improving the social and environmental impact of the financial institution’s management and operational practices.
12. The bonus is based on improving the social and environmental impact of the financial institution’s investments and financial services.

## 4.4 Transparency and accountability

### 4.4.1 What is at stake?

Each individual has the right to know what consequences business activities can have for his or her life and which risks he or she is exposed to in these activities. People whose lives are influenced by economic activities are unable to defend their legitimate interests if they are not fully informed on the social, economic and environmental advantages, as well as the costs and risks connected to that activity. Also, they have to be informed on the possible alternatives for the proposed activity. In order to properly defend their social, cultural and environmental interests, social organisations also have to have access to all relevant information.

For these grounds, the public right of information - with the objective to participate in a meaningful way in the decision-making process - is recorded in various international instruments. Examples are the Universal Declaration of Human Rights, the Rio Declaration on Environment and Development, the Aarhus Convention, the OECD Guidelines for Multinational Enterprises and ISO 26000.

In the first instance, some of these guidelines formulate obligations for governments, but the general principles are obviously applicable to all important social actors, including companies who are also obliged to be transparent on activities that can have consequences for employees, nearby residents and others. Moreover, they have to be prepared to be accountable for it and to listen to the expectations and concerns of other stakeholders. This means that the company has to establish a formal complaints procedure.

More and more companies realise that transparency and accountability is not only their moral duty, but that it can also offer them an advantage. Transparency creates trust. It is the lack of sufficient information and the public perception that managers try to keep certain information secret that causes conflicts and resistance to the activities of companies. Transparency also decreases the risk of corruption. A company that is transparent and prepared to be accountable in this way acquires social approval for its activities.

For financial institutions, transparency and accountability are possibly even more important than for other companies. Contrary to other companies, as capital providers they play an important role in virtually all economic industries. And for the social and environmental consequences of all these economic activities they as investors carry a certain responsibility. To this effect, financial institutions not only have to inform the public of their own activities, but they also have to be as transparent as possible about the companies, projects and governments in which they invest.

For financial institutions, transparency also provides a significant advantage in that they are able to timely recognise and solve the public concerns on activities in which they want to invest before actual conflicts arise. Therefore, multilateral development banks and a lot of export credit insurance companies all have transparency policies that ensure data is made public on all considered transactions.

When developing policies in this respect, financial institutions can make use of the international standards described below.

### 4.4.2 International standards

There are various international standards on transparency (both at the level of the financial institutions as a whole as well as with respect to individual investments) and accountability. The main standards are described here.

- **Finance and investment framework and auditing**

  In order to verify whether financial institutions meet their sustainability promises, financial institutions sometimes conduct internal audits of their credit and investment policies and framework regarding certain sectors and issues and the system put in place to implement those. This includes the due diligence processes. Based on these audits, they can establish whether their system can be improved further.

  It is even better when financial institutions conduct an external audit of their credit and investment policies and framework, including due diligence processes, regarding certain sectors and issues where they can make use of the AA1000 Series of Standards that AccountAbility has developed, a combination of norms on accountability, auditing and reporting. Another system for auditing non-financial information is ISAE 3000, published by the International Assurance and Accounting Standards Board.[619] Preferably, a summary of the results of these audits is made public and discussed with stakeholders.

  Financial institutions should also let their sustainability report be verified externally.

  *This leads to assessment elements 1 and 2.*

- **Transparency on specific transactions**

  It is not sufficient that financial institutions publish positive sounding policy statements. It is important that these policy statements actually lead to more sustainable investment practices. This can only be verified publicly if the financial institution provides insight into loans granted and other investments. On the financial institution's website, stakeholders have to be able to find basic information on all transactions in which a financial institution is involved. And if available, the social and environmental impact assessments on these transactions also have to be publicly available.

  The financial institution should at least specify all regions and industries in a breakdown of its portfolio. Financial institutions often claim that they are unable to publish such information as it harms trust with their clients. However, this argument does not hold water. When a financial institution participates in bank syndicate, it often proudly advertises it in financial magazines. Apparently, the relation of trust with the client does not play a role in these situations.

  But if financial institutions individually grant loans to companies, they can inform these clients in advance that their name could be published. Multilateral development banks such as the World Bank, the Asian Development bank and many others have been setting a good example in this respect for years. Since 1994, the International Finance Corporation (IFC) has a strict Access to Information Policy (AIP). On its website, IFC provides extensive and comprehensive information on its activities, including its investment guidelines and its investments. When IFC finances a certain project, a lot of information on that project is available on its website, such as environmental impact assessments and environmental action plans.[620] Another example is the Italian Banca Etica, that not only publishes information on its loans (name lender, term of the loan, amount), but also on potential transactions that are pending at an external Ethics Committee.

  Commercial financial institutions could follow these examples by:

  - providing an overview in their annual report of the industrial and regional breakdown of the transactions in which they are involved. Such information is required in the GRI Financial Services Industry Supplement (FS6). Stakeholders also quickly gain insight in the sensitive sectors and fields in which the financial institution is active;

- providing an overview of all companies to which it has granted more than EUR10 million credit. The value of this threshold is derived from the Equator Principles, but should not be limited to project finance;
- by providing basic information through their website on the companies in which they invest;
- obliging the companies in which they invest (in some situations) to provide information to involved communities on the social and environmental effects of their activities, such as those included in the Equator Principles for Category A transactions.

If a financial institution does not wish to publish the names of companies it invests in or finances, it may provide insight in its investments based on at least the first four digits, but preferably the first six digits, of the European Nomenclature Statistique (NACE). This standard is similar to the United Nations International Standard Industrial Classification of All Economic Activities (ISIC). The main categories of the Standaard Bedrijfsindeling (Standard Company Classification) of the Dutch Centraal Bureau voor de Statistiek (Statistics Netherlands) are based on it.[621]

Furthermore, banks in Europe can publish the outcome of the European Banking Authority's annual Transparency Exercise. The Transparency Exercise "provides detailed bank-by-bank data on capital positions, risk exposure amounts and asset quality".[622]

*This leads to assessment elements 3, 4, 5, 6, 7, 8, 9 and 10.*

- **Sustainability reporting**

The European Union's Non-Financial Information Disclosure Directive obliges European companies with more than 500 employees to publicly report on at least:[623]

- environmental matters;
- social and employee aspects;
- respect for human rights;
- anticorruption and bribery issues; and
- diversity in their board of directors.

The Directive gives companies significant flexibility in disclosing this information: companies may rely on guidelines such as the OECD Guidelines on Multinational Enterprises, ISO 26000, the United Nations Global Compact, Global Reporting Initiative Reporting Framework or the UN Guiding Principles on Business and Human Rights.

The ISO 26000 guidelines have included transparency as a principle and states that an organisation is responsible "for the impacts of its decisions and activities on society and the environment, through transparent and ethical behaviour."[624]

Likewise, the OECD Guidelines for Multinational Enterprises stress the importance of the disclosure of information: companies "should ensure that timely and accurate information is disclosed on all material matters regarding their activities, structure, financial situation, performance, ownership and governance. This information should be disclosed for the enterprise as a whole, and, where appropriate, along business lines or geographic areas".[625]

In addition, the United Nations Guiding Principles on Business and Human Rights (UNGPs) also expect companies to report publicly: “In order to account for how they address their human rights impacts, business enterprises should be prepared to communicate this externally, particularly when concerns are raised by or on behalf of affected stakeholders”.[626] Companies and financial institutions can make use of the UNGP Reporting Framework to report on their impact on human rights.

In recent years, drafting a sustainability report has become commonplace. The best known guideline for this is the Global Reporting Initiative (GRI) Reporting Framework, of which the latest edition (G4) has been presented in May 2013. GRI encourages financial institutions to not only describe their sustainability policy, but to also measure the respective implementation. Besides the general Reporting Principles and Standard Disclosures there are also Sector Disclosures that elaborate more on the transparency requirements for specific types of companies and industries.

In cooperation with the UNEP Finance Initiative (UNEP FI) in October 2007, GRI published the Financial Services Sector Supplement with specific guidelines with on product portfolios, active ownership, investing in local communities and developing accessible and honest sale of financial products.[627] GRI Sector Supplements are now called GRI Sector Disclosures.

The following requirements on transparency are laid down in the GRI Framework:

- Publication of the policy of the financial institution on specific issues and industries (FS1). If these policy documents are not publicly available, they are of less value. Because financial institutions cannot be hold accountable when people that experience harm or disadvantage from the investments of a financial institution cannot verify to what standards the investments should comply with.
- Providing information on investments, divided according to region, size and sector (FS6: Percentage of the portfolio for business lines by specific region, size (e.g. micro/SME/large) and by sector. This indicator provides contextual information on a financial institution’s portfolio and customer base, and serves as a starting point for further engagement processes with stakeholders. It is particularly relevant when combined with information on environmental and social policies and risk assessment/screening procedures as applied to the different business lines.
- Providing information on how a financial institution deals with investments that do not (or no longer) meet the policy, the norms, or the contract conditions of the financial institution is now explicitly requested. Financial institutions have to report which action they have taken in these situations (for example engagement or exclusion), whether these actions have been successful and what further steps will be taken (FS1, FS2, FS3 and FS10).
- "Voting policy(ies) applied to environmental or social issues for shares over which the reporting organization holds the right to vote shares or advises on voting (G4-DMA, former FS12)". This includes a "summary of voting practices during the reporting period including explanation of significant deviations from voting policies".[628]

Therefore, financial institutions should publish their voting record, engagement activities regarding their investee companies, and exclusion list. This enables stakeholders to assess the sustainable investment practices of a financial institution.

*This leads to assessment elements 11, 12, 13, 15 16 17 and 18.*

- **Consultation**

  Respecting the interests of the stakeholders is one of the principles in the ISO 26000 guidelines: “an organisation should respect, consider and respond to the interests of its stakeholders.” The document also elaborates on ways to implement an effective stakeholder dialogue as part of the social responsibility of organisations.[629]

  Through consultation mechanisms, financial institutions can also consult social organisations on their investment policy on certain sectors and issues. In order to make such consultations effective, it is important that financial institutions translate their policy documents into a language and jargon that is comprehensible to the communities and organisations involved. Such a consultation has to be a dialogue, a two-way process. When financial institutions do not take the concerns, sensitivities and other stakeholders’ contributions seriously, the process is useless. Serious concerns have to lead to adapting the policy of the financial institution and the procedures followed.[630]

  *This leads to assessment element 19.*

- **Grievance mechanisms**

  Financial institutions are also accountable to local communities and other stakeholders for involvement in specific investments. The companies themselves are primarily responsible for the social and environmental effects of their activities; any grievances of communities should first be directed at them. However, this does not absolve a financial institution from the obligation to ensure that all investees meet the standards set by the financial institution in its sector and the issue policies. Therefore, it is important that financial institutions introduce an independent grievances procedure for local communities and other stakeholders that experience effects of activities in which the financial institution invests and for social organisations that defend wider social and environmental interests. They can submit a complaint if they establish that a given investment does not comply with the policy of the financial institution. Most multilateral development banks and more export credit insurance companies dispose of a grievances procedure.[xxv]

  In the United Nations Guiding Principles on Business and Human Rights, John Ruggie, the *Special Representative of the Secretary-General of the United Nations on the issue of Human Rights and Transnational Corporations*, mentions the lack of grievances procedures as a weak point of companies. Also, in all initiatives of financial institutions that want to guarantee compliance with human rights for the companies in which they invest, this is lacking. In an earlier report Ruggie indicated that “In the absence of an effective grievance mechanism, the credibility of such initiatives and institutions may be questioned.”[631] For non-judicial grievance mechanisms, both State-based and non-State-based, to be effective, the UNGPs expect it to be:[632]

  - Legitimate;
  - Accessible;
  - Predictable;
  - Equitable;
  - Transparent;
  - Rights-compatible; and
  - A source of continuous learning.

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xxv See e.g. the World Bank Inspection Panel, the IFC and MIGA Compliance Advisor Ombudsman, the ERBD Independent Recourse Mechanism and the JBIC Examiners for Environmental Guidelines.

The OECD National Contact Points provide independent grievance mechanisms. Financial institutions should cooperate with OECD National Contact Points.

*This leads to assessment elements 20 and 20*

### 4.4.3 Assessment elements

For financial institutions that take social responsibility seriously, a solid policy on transparency and accountability is of great importance. The following elements are crucial for a policy regarding the financial institution's internal operations:

1. The financial institution describes its finance and investment framework regarding environmental and social issues and provides insight into how the financial institution ensures that investments meet the conditions set in its policies.
2. The financial institution’s finance and investment framework regarding environmental and social issues is audited by a third party and the results are published.
3. The financial institution publishes the names of governments in which it invests.
4. The financial institution publishes the names of companies in which it invests.
5. The financial institution mentions and describes all companies (on its website) to which it has granted more than USD10 million credit.
6. The financial institution discloses the names of all project finance deals and project related corporate finance deals, including the information required by the Equator Principles III.
7. The financial institution publishes a breakdown of its portfolio by region, size and industry (in line with GRI FS6).
8. The financial institution publishes a breakdown of its portfolio in a cross table, combining industry and region data.
9. The financial institution publishes a sufficiently detailed breakdown of its portfolio, for example based on the first four digits of NACE and ISIC.
10. The financial institution publishes a sufficiently detailed breakdown of its portfolio, for example based on the first six digits of NACE and ISIC.
11. The financial institution publishes the number of companies with which there has been interaction on social and environment topics (in line with GRI FS10).
12. The financial institution publishes the names of companies with which there has been interaction on social and environment topics.
13. The financial institution publishes the results of this engagement, including the topics, goals and deadlines.
14. The financial institution publishes the names of companies that are excluded from investment due to sustainability issues, including the reasons for this exclusion.
15. The financial institution publishes its voting record.
16. The financial institution publishes a sustainability report that may contain (a number of) Standard Disclosures from the GRI G4 Sustainability Reporting Guidelines.
17. The financial institution publishes a sustainability report that is set up in accordance with the GRI G4 Sustainability Reporting Guidelines, which includes the Financial Services Sector Supplement (FSSS).
18. The financial institution’s sustainability report has been verified externally.
19. The financial institution reports on the consultation with civil society organisations and other stakeholders.
20. The financial institution establishes an internal grievance mechanism for individuals and communities which may be adversely impacted by its activities.
21. The financial institution shall abide by the decisions of an independent grievance mechanism for individuals and communities which may be adversely impacted by its activities.

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