Submission from Fair Finance India

Case for inclusion of Financial Institutions in National Action Plan on Business and Human Rights

Fair Finance India (FFI) is a civil society coalition working towards ensuring a sustainable financial sector in the country. By encouraging higher level of public disclosure by banks, we want to promote greater transparency and accountability in the functioning of these institutions. Being custodians of large sums of public money, it is important they realise the impact of their operations directly as well as those linked to the companies they finance. Banks have a huge impact on the economy-on the people they are intended to serve, and on the environment on which we all depend. Consequently, integrating Environment, Social, and Governance (ESG) standards in their policies is crucial.

While Internationally, there is the Global Reporting Initiative (GRI) sustainability reporting standard which allows businesses to understand and voluntarily communicate their impact on critical sustainability issues such as climate change, human rights, governance, and social well-being[1], in the national context we have the National Guidelines on Responsible Business Conduct (NGBRC) and Business Responsibility Reports that promote non-financial disclosures among companies on ESG issues.

FFI, as a part of Fair Finance Guide International (FFGI), an international civil society network, seeks to strengthen the commitment of banks and other financial institutions to social, environmental, and human rights standards. FFGI, with presence in 11 countries across the world, aims to develop a self-reinforcing process resulting in sustainable credits, investments, risk management, and asset management all over the world.

To support this, Fair Finance India along with its coalition members is working towards ensuring the increasing uptake for ESG considerations among banks while taking financial and investment decisions. In line with this objective, the coalition is assessing eight Indian banks - public and private, of different size (based on total assets, revenue and market capitalization) - on ten themes across various ESG criterias. Banks, which are a part of the assessment include:

Bank of India (BoI)	India Overseas Bank (IOB)
Federal Bank	PNB
HDFC Bank	SBI
IDFC First	Yes Bank

Highlights of the Study

In 2018-2019, the coalition conducted a baseline to analyse the banks vis-a-vis its ESG considerations in investment decisions. The study revealed that while the banks have some internal processes in place with regard to ESG related issues, it does not necessarily get extended to banks lending decisions. In other words, internally the banks have policies and processes that ensure their commitment towards Human Rights, Environment and Transparency and Accountability, however, while making investment decisions, the same policies of the investee companies are not evaluated as a part of risk assessment, indicating lack of due diligence processes.

[1] https://www.globalreporting.org/information/about-gri/Pages/default.aspx

Environment[2]

The global threat to climate change is real and India will be among the worst hit countries that may face the consequences of natural calamities affecting the lives and livelihoods of millions of people, especially the most vulnerable and marginalised communities.

The National Voluntary Guidelines on Responsible Finance recognises that Financial Institutions (FI) should minimise the negative impacts of their business operations on the environment in which they operate[3]. However, what the guidelines do not cover is the indirect impacts of the banking operations on the environment, created due to the projects and businesses being financed by the banks. Year-on-year lending to fossil fuel projects such as coal mines, large infrastructure projects in geo-sensitive zones, are examples of such indirect impacts. Implications of climate change for the finance sector are reported to be higher than on other industries. It is estimated that the financial services industry accounts for 72 per cent ($ 692.8 billion) of the total potential financial impact of climate change[4].

Climate change is intertwined with social issues as well. For example, due to rising sea levels, we all know that the most marginalised and vulnerable communities living on the brink will be the most affected; forcing large scale displacement and migration[5]. FIs need to adapt both their operations and lending practices, to mitigate effects of climate change on environment as well as people.

However, Indian banks seem to be reluctant in adopting these principles around climate change and preservation of nature, as far as their corporate lending and project financing activities are concerned. While initiatives are reflected in the internal functioning of the banks, including reducing the use of electricity and paper consumption, most of the banks do not assess the commitment and disclosure on part of the companies being lent the financial support. IDFC, however, is a pioneer in this regard, due to adoption of the Equator Principles, which ensures minimum standard for due diligence and monitoring to support responsible risk decision-making. Yes Bank also discloses information on governance, strategies, risk management and targets in line with the recommendations by the Task Force on Climate-related Financial Disclosures (TCFD).

Social[6]

Lending policies and practices of FIs can play a decisive role in minimising human rights violations. Banks may not be direct contributors to human rights violations; however, they can enable and facilitate such violations indirectly by lending to companies which cause these violations. Human rights violations are a potential ESG risk to the banks' lending and not having a robust ESG risk-framework makes the banks accountable for the human rights violations[7]. FIs' must take effective measures such as Human Rights Due Diligence, to ensure that the rights of people, especially the marginalised and vulnerable communities, are protected.

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[2] As a part of the methodology to assess FI's commitment towards environmental factors, the elements assessed were Nature and Climate Change.

[3] https://www.cafral.org.in/sfControl/content/LearningTakeaWays/1213201764617PMNationalVoluntaryGuidelinesforResponsibleFinancing.pdf

[4] https://fairfinanceindia.org/media/495381/fair-finance-india-report_1311_final.pdf

[5] https://www.nationalgeographic.com/environment/2019/01/climate-change-drives-migration-crisis-in-bangladesh-from-dhaka-sundabans/

[6] As a part of the methodology to assess FI's commitment towards social factors, the elements assessed were Gender Equality, Human Rights, Labour Rights, Arms and Financial Inclusion.

[7] https://www.banktrack.org/article/human_rights_are_banking_risks

Post nationalisation of banks in India in 1969, the central government along with state governments, RBI and Public Sector Banks (PSBs) worked together to take banking to the masses. Thus, most of the assessed banks are doing well with respect to financial inclusion, owing to the government mandate and focus. However, the same is not true when it comes to other social aspects where such mandate is not explicit: such as protecting and promoting gender equality in their internal operations as well as in their lending operations to companies. For example, while almost all the assessed banks have a policy on sexual harassment, they fail to address the broader issues of gender discrimination and harassment at the workplace, and these policies are not extended to the projects that they finance. Similarly, none of the eight banks expect the companies they are investing in to have policies on pay equity or to ensure minimum 30% participation at senior level positions.

Yes Bank as a signatory to the United Nations Global Compact reports its Communication on Progress at GC Advanced level and is a part of the Governing Council of UN Global Compact Network India (UNGCNI). The ten principles of the UNGC include adherence and reporting on principles relating to Human Rights, Labour Rights, Environment and Anti-Corruption. Although the other banks mention about 'respecting' human rights, none of them expect the companies they are financing to adopt internationally accepted human rights principles such as the UNGPs, a framework for human rights observance, designed to enhance observance of existing standards. As far as labour rights are concerned, most banks show policy commitments to various components of the ILO Declaration on Fundamental Principles and Rights at Work, such as no employment of child labour and forced labour, freedom of association and collective bargaining, etc. However, none of them explicitly state out the need for their financed companies to uphold the same commitments. HDFC is the only bank that has a policy which considers 'no exploitative/child labour/forced labour' as a factor before taking any credit call on long term loans.

Governance[8]

Greater transparency and accountability are key to minimise incidents of corruption, frauds, money laundering, and other undesirable outcomes.

Incidents in the past couple of years point to governance related flaws that exist in the Indian banking sector. Interestingly, Corruption is the second highest scoring theme in our assessment, after Financial Inclusion. This is so because almost all banks have policies pertaining to internal operations, such as Anti-Money Laundering policy (AML) and Know Your Customer policy (KYC). However, it must be noted that even banks that disclose information on various internal parameters and seem to be high on governance standards have been found lacking in implementing their policies into practise, leading to increasing NPAs and piling up of loans. The banks do not disclose important aspects such as disclosing the names of companies to which they grant credit. This is a major setback, because often financial linkages of a project are established only when a major violation is reported which catches people's attention. For cases which do not get traction, it is difficult to hold the funding institution accountable

Among the banks evaluated Federal Bank mentions that its Whistle Blower policy extends to stakeholders beyond their customers, including NGOs and public at large. Most banks demonstrate unwillingness to take accountability for the violations linked to their lending indirectly. Therefore the inclusion of FIs in the NAP is an urgent need to ensure accountability and ownership.

[8]As a part of the methodology to assess FI's commitment towards governance factors, the elements assessed Corruption, Tax and Transparency and Accountability

It is important to emphasise that the understanding and identification of ESG related risks associated with the lending practices of financial institutions should be a non-negotiable, as these have an impact that reaches beyond their borrowers and customers to the broader economy and the environment. With the increasing acceptance of ESG by investors worldwide, and ESG funds giving better returns[9], the impact is also being felt in India, with many banks coming up with various products such as Green Bonds. However, while the banks have considerable public disclosure on policies pertaining to their internal functioning, the need for banks to mandate ESG due diligence processes for financed companies is highly inadequate.

Overall, the findings of the assessment indicate that the private sector banks seem to have better policy disclosures than the PSBs across various themes and components involved in ESG lending. One reason for this could be market competition and attraction of new investors. However, banks, governments, and CSOs should jointly reflect more on this. There is also scope of creating a business case around this, as the positive relationship between profitability and long-term strategy on sustainable finance is well established.[10,11]

Recommendations

Based on the above scenario, some **recommendations** which the NAP should ensure with respect to financial institutions are:

Pillar 1-State duty to protect

- The Right to Information Act 2005 should be extended to cover all financial institutions, especially the ones that disperse loans beyond a threshold amount to a single company/project.
- The BRR reporting at the moment is not statutory and needs to be made more relevant to the financial sector. A separate reporting format should be developed for them.
- Disclosure from banks should include mandatory listing of companies it lends to along with the factors that led to investing decisions.
- National Voluntary Guidelines in Responsible Financing should be revised and its adoption by financial institutions must be ensured.

Pillar 2-Corporate Responsibility to Respect

- Banks should have ESG Risk Assessment Frameworks for its financing activities. These should be publically disclosed through policy commitments
- They should ensure that third party due-diligence from their end both during project initiation and project renewals.

[9]https://www.thehindubusinessline.com/opinion/columns/slate/all-you-wanted-to-know-about-esg-funds/article30965272.ece

[10]https://businessperspectives.org/images/pdf/applications/publishing/templates/article/assets/10758/BBS_2018_03_Ahmed.pdf

[11]https://www2.deloitte.com/content/dam/Deloitte/lu/Documents/financial-services/Banking/lu-do-sustainable-banks-outperform-driving-value-creation-through-ESG-practices-report-digital.pdf

Pillar 3-Access to Remedy

- Banks have the responsibility to ensure the economic and social viability of its financing activities, both for the businesses and communities that may be impacted by these activities. It is therefore crucial that they open up their grievance redress and whistle blower mechanisms to entities beyond their direct operations, such as CSOs, project affected communities and other stakeholders.