The Human Rights Dimensions of a Sustainable Financial System: Meeting Report

Co-convened by the Institute for Human Rights and Business and the United Nations Environment Programme, 14:00-17:00, Thursday 4 December 2014, UNEP Regional Office for Europe, Geneva, Switzerland

Background on the UNEP Inquiry in the Design of a Sustainable Financial System

The UNEP Inquiry was launched in January 2014 to explore how the rules that govern the financial system – standards, metrics, incentives, regulations – can better mobilize capital for sustainable development. The Inquiry will present policy options at the end of 2015 suggesting how capital can be steered from resource-intensive assets towards an inclusive, green economy. To date, the Inquiry has engaged in a number of international collaborations with organisations such as the OECD and the World Bank and worked at the country level to understand real world challenges, innovations and prospects: Bangladesh, Brazil, China, Colombia, EU, India, Indonesia, Kenya, Switzerland, South Africa, UK and the USA. It has also looked at critical sectors within the financial system such as banking, insurance and institutional investment, and also developed scenarios setting out diverse pathways to achieve sustainability. It has produced a series of progress reports including Aligning the Financial System with Sustainable Development - Pathways to Scale**.** It will present its final report at the end of 2015.

A sustainable financial system is clearly one that operates with integrity, equitably and inclusively, while avoiding harm to people and their livelihoods. In particular, how would a human rights focused examination of the rules of financial systems bring different perspectives that would better promote the goal of sustainable development? Specifically:

- How does the financial system impact on the observance of human rights by financial institutions and their clients?
- Does today's enlarged and economy-shaping monetary policy have unintended human rights implications?
- Will Basel III do more than define bank's capital requirements in effecting human rights outcomes?
- Do dark pools and high frequency trading, recently highlighted in the media as involving questionable ethics and outcomes, also have distinct human rights outcomes that need to be more effectively policed?
- If you were advising the Peoples Bank of China or the European Central Bank, what human rights-sensitive policies and regulations would you advance?
- Ultimately, what kind of financial system do we want that is aligned, not just compliant, with the needs of human rights?

Framing the Inquiry's Interest in the Human Rights Dimensions of the Financial System

The Inquiry is looking at the roles of those who govern the financial sector - central bankers, ministries of finance, banking regulators, accounting bodies - rather than looking at the practices of individual financial institutions. In its work, it has identified four reasons for taking action within the financial system on environmental and social imperatives:

1. Financial market failures: weaknesses within the financial system can put barriers in the way of sustainable development: short-termism, misaligned incentives, inadequate information disclosure.

2. Systemic risks: financial institutions are often poorly placed to manage new environmental and social risks particularly those that are weakly or poorly priced, or extend over the long-term such as climate change.

3. Innovation: necessary financial innovation for sustainable development is often blocked by obsolete practices requiring government action to promote financial inclusion and green bonds.

4. Policy coherence: financial stability is the core mandate for central banks and regulators, but many have other objectives such as growth and employment. Increasingly, regulators are realizing that their rules (such as Basel rules on bank stability) need to be designed in accordance with sustainable development.

The crisis has taught central banks that finance can impose 'externalities' onto others – costs and disruptions that need to be curbed via robust regulation. This provides a starting point to think about the human rights dimension – what are the externalities that financial transactions are causing in terms of breaches of human rights and how should regulators respond to curb these practices?

Session 1: Human Rights Considerations at the Macro / Structural / Systemic Level

Guiding Questions Presented for Discussion

- The recent global financial crisis created severe human rights impacts across the world, such as loss of employment, income, and access to food, housing, education, healthcare, and public welfare services. Those already poor were affected the most. What are the gaps in the current financial system that created these conditions?

- As we think through the new structure of a sustainable global financial system, how do we ensure that fiscal and monetary policies serve the needs of people and their human rights, as opposed to the needs of the financial system, its institutions, and those who control such institutions? How do we ensure that the gaps are addressed in the process of setting new policy? What mechanisms and tools are available to do this?

- Are the gaps in the current financial system only observable with human rights lens or can other conceptual framework or discipline enable similar observations?

The discussion focused on parsing through important distinctions and mismatches in order to get started on considering why and how human rights should be taken into consideration in financial regulation. Some participants drew a clear distinction between green economy considerations and human rights - the former is about right pricing and markets, but the latter is about challenging 40 years of financial theory. Central banks are key. They look at the efficiency of markets at the macro level and assume that improved human welfare will follow. But human rights are grounded in the micro level – in individuals, in communities, in workplaces. A key challenge is in bridging that conceptual gap from both sides: prompting the human rights community to take on the challenge of addressing human rights at the level of the aggregate financial system, while prompting financial regulators to consider the impact of financial regulation at the individual level.

The **UN Protect, Respect, Remedy Framework on Business and Human Rights**[1] could be a useful framework for the Inquiry's work. The focus should be on both the obligations of governments and the responsibility of companies (including companies in the financial sector) to respect human rights. The UN Protect, Respect, Remedy Framework reminds governments that under international human rights treaties, they have an obligation to protect human rights, through their own actions and to prevent and punish human rights abuses by companies, including those in the financial sector.

The financial crisis and its aftermath demonstrated that financial system failures can have catastrophic consequences for a wide range of human rights. In 2012 the World Bank reported that 114 million more people are living in poverty because of the financial crisis. The financial system acted as a multiplier of vulnerability. The response to the crisis focused on institutions – rather than on the impacts, leaving millions without a remedy that would be expected under a human rights approach. So one way to understanding a human rights based approach to financial regulation is to emphasize the government's obligations to protect people from human rights abuses.

The financial system is complex and needs technical solutions but human rights theory is currently poorly equipped to inform these technical solutions beyond basic (but important concepts) such as participation, transparency, accountability which are concepts that both human rights people and financial regulators can understand. Financial liability is one way to connect the two agendas: lender liability for indirect damage has been a longstanding issue in the environmental agenda – and is growing in importance in countries such as Brazil and China. Another route is to focus on resilience – a society that is based on respect for human rights and the rule of law is likely to be more resilient and deal better with external shocks than societies with widespread violations. The IMF has acknowledged that economies with low degree of inequality grow faster. Ultimately, this means re-examining the multiple purposes of the financial system and the mandates of for those who supervise the system.

Risk was considered an important entry point for the discussion, including with Central Banks which have controlling systemic risk as a core mandate. Human rights need to become an integral part of the "how" the financial system deals with risk. Human rights violations can create systemic risks for the financial system - but the financial system can also create systemic risks for human rights, as the recent financial crisis demonstrated. It is this long-term and more intertwined issue about stability that needs to be conveyed to capture the attention of the financial sector and its regulators.

Regulators are keenly aware of the need to consider aggregate risk and are looking for new thinking around risk. They are open to new approaches on how to manage systemic risks and are open to new approaches to managing risks better. But this still probably requires explaining how human rights affect credit risk or other types of risk. Financial regulators engaging with human rights need to be able to grasp the essence of human rights and "translate" them into their own way of working. As one participant noted, there needs to be "recognition, data, implementation". Some regulators are breaking new ground: in Brazil - and shortly Peru –

[1] The meeting was held in Geneva just following the UN Annual Forum on Business and Human Rights where the UN Protect, Respect, Remedy Framework and its implementing set of UN Guiding Principles on Business and Human Rights, were the focus of discussions involving 2000+ people for three days.

regulators have issued regulations requiring banks to incorporate environmental and social considerations into their routine risk management and due diligence systems

Human rights are not yet "visible" to most regulators so they do not even recognise or even consider them. They need to be made relevant to the regulator's consideration around mobilizing capital to generate assets and livelihoods. Regulators also have to be able to address these issues through the use of data to support policy choices and implementation. Regulators need definition and prioritization. Under international human rights law, it is not acceptable to rank human rights (i.e. identifying some rights as more important than others) but it is quite appropriate and often necessary to identify which rights are relevant in each context and prioritise those.

One of the key challenges is that it is hard to assess human rights risk; there are fewer accepted metrics. There are many more tools on the environmental side. But there are good bridges between environmental policies and human rights policies. UNEP FI just issued a report on Basel III and how it relates to environmental risk,[2] including on stress testing, so this might provide a helpful model.

The insurance sector offers considerable potential for aligning financial stability and human rights. From an insurance point of view, this "translation" may come more naturally because insurers already have as their main objective the use of capital to protect people. The insurance sector understands that risks and human rights are interlinked. For example, the work on inclusive insurance markets for low income communities includes access to insurance for those with disabilities and HIV. Financial innovations linked to the UN's disaster work which have a mandate to focusing on protecting people may provide an open opportunity to integrate human rights considerations. The International Association of Insurance Supervisors has said that human rights and the fair treatment of customers is relevant to the insurance mandate.

Session 2: Human Rights Considerations at the Micro / Transactional Level

Guiding Questions Presented for Discussion

- The risk management procedures to address human rights risks used by banks and insurers don't address other risk taking that occurs in financial institutions as witnessed by the recent financial crisis (e.g., derivatives). Such risk taking leads to microprudential issues, which can then trigger macroprudential crisis in a country. How do we encourage human rights due diligence by financial institutions in areas beyond project and corporate finance, and what does such human rights due diligence look like?

- The UN Guiding Principles on Business and Human Rights require that human rights risks are gauged from the rightsholder's perspective and not the financial institution's. How does this perspective inform the financial institution's perceptions of human rights risks and how it carries out human rights due diligence?

To date, most of the consideration of the relationship between human rights and finance has looked at the particular impact of an operation, company or project financed on human rights. Human rights are starting to be embedded in these product lines where it is easier conceptually and methodologically to incorporate a human rights based approach. For example, the Thun Group of banks recently issued a draft paper on incorporating

[2]UNEP FI, Stability & Sustainability in Banking Reform: Are Environmental Risks Missing in Basel III? (2014)

human rights into retail and private banking, corporate and investment banking and asset management.[3] The OECD Investment Committee has ongoing work on looking at the application of the human rights chapter of the OECD Guidelines on Multinational Enterprises to the financial sector.[4]

For investors, there are other levers that regulators can use that perhaps have not been sufficiently explored: the concepts of fiduciary duty and materiality. Investors say that they are addressing the key issues that clients ask about. So part of the focus should be in prompting clients to ask human rights questions. Another angle is to address human rights through director and officer liability policies. These can be triggered when they engage in wrongful/misleading acts – does that extend to engaging in human rights abuses?

In addition to these examples, participants highlighted three other areas of potential massive risks for human rights that have not yet been sufficiently addressed:

> i. Bank "de-risking" and shedding loans to small and medium sized enterprises. This is the opposite of financial inclusion, making it harder and harder for individuals and smaller players to access credit.
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> ii. Tax planning which has highlighted the three economies that are operating globally: first, the informal economy; second, the regular economy – where corporations pay tax; and third, the avoidance/evasion economy where financial actors can enable individuals and institutions to evade taxation. Ultimately, the lack of revenue means states cannot pay for services that correspond to human rights. And while this argument has been made at the OECD's discussions on Base Eroding and Profit Shifting (BEPS), the rights discourse has otherwise not played a role.
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> iii. Commodity markets where the operation of the financial system results in speculation that negatively impacts on the availability and price of energy, food, water, etc.

Wrap Up

The discussion demonstrated the rich set of linkages between financial system regulation and human rights – many of which have yet to be fully explored. There is a potential for a powerful reciprocal relationship – which the Inquiry and the IHRB will explore through further research and dialogue.

[3] http://business-humanrights.org/en/statement-by-the-thun-group-of-banks-%E2%80%9Cthe-guiding-principles-an-interpretation-for-banks%E2%80%9D-banks-in-barclays-bbva-credit-suisse-ing-bank-rbs-group-ubs-unicredit
[4] http://mneguidelines.oecd.org/rbc-financial-sector.htm

Annex 1: Participant List

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