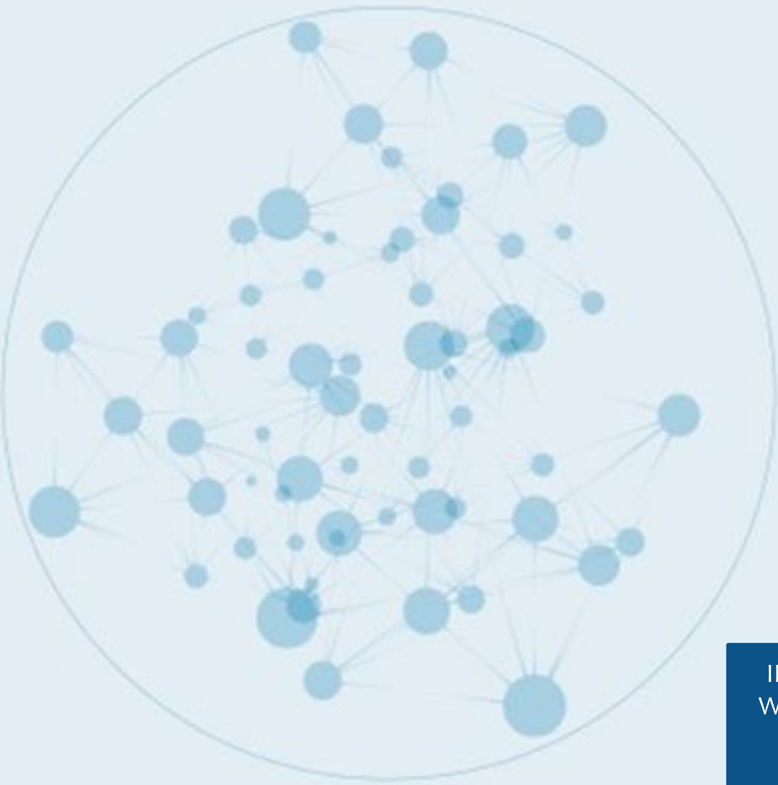
Inquiry: Design of a Sustainable Financial System

Institute for Human Rights and Business

UNEP

HUMAN RIGHTS AND SUSTAINABLE FINANCE

Exploring the Relationship



INQUIRY WORKING PAPER

16/01

February 2016

The UNEP Inquiry

The Inquiry into the Design of a Sustainable Financial System has been initiated by the United Nations Environment Programme to advance policy options to improve the financial system's effectiveness in mobilizing capital towards a green and inclusive economy—in other words, sustainable development. Established in January 2014, it published its final report, The Financial System We Need, in October 2015.

More information on the Inquiry is at: *www.unep.org/inquiry* and *www.unepinquiry.org* or from: Ms. Mahenau Agha, Director of Outreach *mahenau.agha@unep.org*.

About IHRB

IHRB is a global centre of excellence and expertise - a think and do tank - on the relationship between business and internationally proclaimed human rights standards. The Institute works to raise corporate standards and strengthen public policy to ensure that the activities of companies do not contribute to human rights abuses, and in fact lead to positive outcomes. IHRB works with business leaders, government officials, civil society, and trade unions to address problems where the law may be unclear, where accountability and responsibility may not be well-defined, and where legitimate dispute settlement mechanisms may be non-existent or poorly-administered.

IHRB has presence in London, Brussels, Geneva, and Washington, DC, in addition to three responsible business centres in Colombia, Kenya, and Myanmar, and is part of a consortium that works on business and human rights in China.

Much of IHRB's sectoral and thematic focus is based on key "global flows" that underpin globalization. This paper is part of IHRB's program of work on the global flow of finance.

Authors

Margaret Wachenfeld is the Director of Research and Legal Affairs at IHRB. Motoko Aizawa is Managing Director USA at IHRB. Mary Dowell-Jones is a Research Fellow at the Human Rights Law Centre, University of Nottingham, specializing in the financial sector and human rights. Her work focuses on ethics and governance of the global financial system, systemic risk and financial crisis, and financial regulation.

About this paper

This paper reflects information updated through mid-September 2015.

Comments are welcome and should be sent to *nick.robins@unep.org***.**

Acknowledgements

Participants in three consultation meetings held in Geneva (December 2014),[1] London (March 2015), and Washington, D.C. (April 2015) helped identify existing or ongoing research and reports and shape the structure of this Report. The authors are grateful to all those who participated in the discussions.

IHRB thanks Amy Lehr (also IHRB Research Associate), Melissa Stuart and Corentin Chevallier of Foley Hoag LLP for their pro bono research on the issue of financial sector legal liability and environmental liability.

The authors also benefited from an informal peer review by Daniel Bradlow, Aldo Caliari, Jong Hwang, Rob Lake, Benoît Lallemand, Amy Lehr, Susan Mathews, Herman Mulder and Salil Tripathi.

Abbreviations

AFI	Alliance for Financial Inclusion
BCBS	Basel Committee on Banking Supervision
BIS	Bank for International Settlement
CDS	Credit Default Swaps
CGAP	Consultative Group to Assist the Poor
CISL	Institute for Sustainability Leadership, University of Cambridge
ECB	European Central Bank
E&S	Environmental and Social
ESIA	Environmental and Social Impact Assessment
ESG	Environmental, Social and Governance
FSAP	Financial Sector Assessment Programme
FSB	Financial Stability Board
G8	Group of 8
G20	Group of 20
GEF	Global Environment Facility
G-SIB	Global Systemically Important Banks
IAIS	International Association of Insurance Supervisors
ICP	Insurance Core Principles
IFC	International Finance Corporation
IFI	International Financial Institutions
IMF	International Monetary Fund
ILO	International Labour Organization
IOSCO	International Organization of Securities Commissions
MNE	Multinational Enterprises
OECD	Organisation for Economic Co-Operation and Development
OHCHR	Office of the High Commissioner for Human Rights
PRI	Principles for Responsible Investment
PSI	Principles for Sustainable Insurance
RFF	Responsible Finance Forum
SBN	International Finance Corporation's Sustainable Banking Network
SDG	Sustainable Development Goals
SEC	US Securities and Exchange Commission
SRI	Socially Responsible Investing
SSI	Sustainable Stock Exchanges Initiative
UNEP	United Nations Environment Programme
UNEP FI	United Nations Environment Programme Finance Initiative
UNGP	UN Guiding Principles on Business and Human Rights

Contents

List of boxes

EXECUTIVE SUMMARY

Designing and building a sustainable financial system requires a broad focus on what sustainability requires in all its aspects and how finance can help deliver on that important objective. This task includes not only delivering financing for sustainable environmental outcomes and addressing climate change, but it also includes attention to the needs of a sustainable society. Societies in which segments of the population suffer extreme poverty, marginalization and discrimination, lack access to basic health care and education, or lack the rule of law or freedom of speech, or must cope with dysfunctional, corrupt or unaccountable public institutions, create social pressures which, in turn, strain environmental and economic resources. It is difficult if not impossible to address the needs of a sustainable planet without taking into account the critical role that a sustainable society plays. It follows that a sustainable future for all requires a coherent vision of how the layers of society, economy, environment, and finance interact, and the role of the financial system in facilitating sustainable livelihoods and societies.

This joint paper (the Paper) between the UNEP Inquiry on the Design of a Sustainable Financial System and the Institute for Human Rights and Business,[2] together with Mary Dowell-Jones, aims to contribute to this debate through considering the role of human rights in delivering a sustainable finance system. Human rights set out a vision of the key values and fundamental social goods that are essential to stable societies and sustainable economies. These include the rule of law, democratic accountability, rights to life, liberty, security of person, and freedom of speech, and broader economic rights such as the right to work, the right to social security, and the rights to education and health care, among others. As well as being human rights, these are also recognized as key economic goods which help to underpin development, growth and stable societies through providing accountable institutions, healthy, educated and skilled workers, security in old age, and a safety net in times of economic disruption or transition.

The International Bill of Human Rights[3] and the newer 2011 United Nations Guiding Principles (UNGPs) on Business and Human Rights[4] remind states of their obligations to protect these human rights, including by appropriately regulating businesses, including financial institutions, to ensure that they respect human rights. The UNGPs framework set an expected global standard of conduct for all businesses, including financial institutions, that they respect human rights. While this is a soft law standard, it is an authoritative global standard[5] and one that is moving from soft law to hard law as it is incorporated by reference into other international standards,[6] domestic law, and contracts. As human rights become increasingly coded into other areas of international law, including international commercial law, they offer the only shared framework of basic values and critical social goods which can be used as a reference point for a code of ethics and standards of expected conduct in the financial sector.

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. The opportunity that lies ahead is the evolution of a sustainable financial system that is more closely aligned with that vision of social sustainability, as signalled by the international human rights framework.[7] This is the optimistic message from this Paper based on changes in the sector already underway. But the other message from the Paper is that there is still a long way to go. The Paper provides an overview of several key areas where human rights are currently applied in the financial system, highlights the need for further expansion of the application of human rights to the sector and for further research. The increasing attention given to these issues by international organizations, and the research cited throughout the Paper point to a growing interest and appetite across the financial sector and human rights sector to engage in these important discussions.

The Paper analyses three levels of interaction between the financial system and human rights: (i) the **systemic** level, that looks at regulatory actors and key regulatory leverage points for (further) incorporating human rights into regulatory approaches, as well as considering the more diffuse impacts on human rights of the operation of the financial markets; (ii) the **client** level, which looks mainly at how financial institutions in certain segments of the market (banking, investment and insurance) address the identifiable human rights impacts of their sovereign and corporate clients' activities while also highlighting that further work is needed to identify and explore ways to manage the human rights impacts of more complex products and services; and (iii) the **consumer** level, which looks mainly at how financial institutions in certain segments of the market (banking, investment and insurance) address the human rights impacts of their products and services directly on consumers and promote human rights enjoyment through new products and services.

By looking at these three levels, the Paper seeks to highlight the multi-faceted roles and contribution that human rights can make to a more sustainable and more ethical financial system. At the systemic level, human rights are an ideal and an inspiration for a vision of a better society, an expression of ethics grounded in the belief of the inherent dignity and equal and inalienable rights of all members of the human family that is an important foundation not only for ethical approaches to the financial sector's business, but also a benchmark against which to measure its consequences. They expose the technical agnosticism of the modern financial system, based around abstract mathematical formulas and quantitative models. At the client level, they are an expression of the social externalities that governments and businesses are expected to internalize, if the world is to move in a more sustainable direction. They are considerations for risk management to help financial institutions assess the conduct of corporate and sovereign clients to ensure that they are not linked to human rights abuses. They also help financial institutions determine how to fund economic activity in a way that does not further contribute to human rights abuses and expose themselves to risk but instead contributes to the enjoyment of human rights. At the consumer level they are an expected standard of conduct for financial institutions, and provide a benchmark for respecting and treating the interests of consumers fairly and without discrimination. They underpin legal frameworks to be deployed to protect people from harm and defend against injustice. In other words, there is more than one concept of human rights that is useful to improving the sustainability and inclusiveness of our complex financial system.

At the **systemic** level, the Paper highlights that a key challenge in moving from modern finance to sustainable finance is the methodological disconnect between the capabilities of mathematical finance and ethics. Financial markets have a long history as part of human society, and for much of that time they have been reasonably straightforward support services for facilitating economic activity where the economy and finance were seen as part of the social fabric, rather than as a separate, self-governing system.[8] Over the last twenty years, as the financial system has changed beyond recognition, this implicit relationship between financial markets and a context of unspoken, broadly accepted social values has broken down. Not only is there a need to improve the data and the assumptions that go into the mathematical formulas and quantitative models so that they better reflect the social complexity in which financial products are used, but significantly, there is also a need for regulatory checks on what can in practice be widespread negative and unsustainable social, economic, and financial consequences. In order to build a more sustainable and resilient financial system for the future, it is essential that the broad range of social impacts of financial activity are included in the debate on the management and regulation of the financial system. A human rights lens can help to integrate these social impacts more deeply into the financial architecture.

Also at the **systemic level**, with respect to financial regulation, the role of central banks vis-à-vis human rights has been little discussed to date, yet major central banks have recently expressed concern over the impact of extraordinary monetary policy measures in stoking global inequality, which is also a key issue for the human rights community. There is scope and arguably a need for human rights considerations to play a role in central bank economic research and monetary policy deliberations, so that the range of social impacts of monetary policy decisions on different groups – including the marginalized – are included in debate. Central banks also have controlling systemic risk as a core mandate. Some central banks are beginning to recognize that human rights abuses leading to social instability can create systemic risks for the financial system and, as such, are an appropriate consideration in financial sector supervision. The financial system can also create systemic risks for human rights, as the recent financial crisis demonstrated. It is this potential threat to macro-level stability over a longer time horizon arising from micro-level risks to human rights that needs to be conveyed to capture the attention of further financial system regulators. The Paper also examines nascent steps of regulators of other selected segments of the financial market – banking, investment and insurance – in beginning to address social issues, much less human rights issues, as part of their mandates, and finds that there is in most cases a very long way to go for most regulatory frameworks.

At the **client level**, individual financial institutions have made progress over the last decade or so, building on the experience of environmental due diligence by some banks and insurance companies, in defining what steps they should take in respecting human rights in their business relationships with their sovereign or corporate clients. Financial institutions are seeing human rights as a new dimension of risk in their risk management, particularly in connection with long-term finance and equity investments, usually as part of the "S" in considering environmental, social and governance (ESG) issues. Indeed, a human rights lens ensures that "S" issues are consistently and comprehensively organized and addressed. And yet human rights also address "E" (for environment) and "G" (for governance) in the ESG triumvirate – environmental degradation directly affects human rights, and corporate governance rules require that stakeholders' interests are taken into account. At the same time the "S" dimension of due diligence is often the weakest and least explored part of the ESG triumvirate.

At the **consumer level** is where the positive opportunities have been seized most visibly, where financial inclusion, impact investing, and impact insurance are starting to take off, having a direct impact on poverty reduction, and is also making fulfilment of certain human rights a reality. The financial system