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The promotion of respect for workers' rights in the banking sector:

Current practice and future prospects

Emily Sims

Multinational
Enterprises
Programme

Job Creation and
Enterprise
Development
Department

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Preface

The primary goal of the ILO is to contribute, with member States, to achieve full and productive employment and decent work for all, including women and young people, a goal embedded in the ILO Declaration 2008 on *Social Justice for a Fair Globalization, and*[1] which has now been widely adopted by the international community.

In order to support member States and the social partners to reach the goal, the ILO pursues a Decent Work Agenda which comprises four interrelated areas: Respect for fundamental worker's rights and international labour standards, employment promotion, social protection and social dialogue. Explanations of this integrated approach and related challenges are contained in a number of key documents: in those explaining and elaborating the concept of decent work[2], in the Employment Policy Convention, 1964 (No. 122), and in the Global Employment Agenda.

The Global Employment Agenda was developed by the ILO through tripartite consensus of its Governing Body's Employment and Social Policy Committee. Since its adoption in 2003 it has been further articulated and made more operational and today it constitutes the basic framework through which the ILO pursues the objective of placing employment at the centre of economic and social policies.[3]

The Employment Sector is fully engaged in the implementation of the Global Employment Agenda, and is doing so through a large range of technical support and capacity building activities, advisory services and policy research. As part of its research and publications programme, the Employment Sector promotes knowledge-generation around key policy issues and topics conforming to the core elements of the Global Employment Agenda and the Decent Work Agenda. The Sector's publications consist of books, monographs, working papers, employment reports and policy briefs.[4]

The *Employment Working Papers* series is designed to disseminate the main findings of research initiatives undertaken by the various departments and programmes of the Sector. The working papers are intended to encourage exchange of ideas and to stimulate debate. The views expressed are the responsibility of the author(s) and do not necessarily represent those of the ILO.

José Manuel Salazar-Xirinachs
Executive Director
Employment Sector

[1] See http://www.ilo.org/public/english/bureau/dgo/download/dg_announce_en.pdf

[2] See the successive Reports of the Director-General to the International Labour Conference: *Decent work* (1999); *Reducing the decent work deficit: A global challenge* (2001); *Working out of poverty* (2003).

[3] See http://www.ilo.org/gea. And in particular: *Implementing the Global Employment Agenda: Employment strategies in support of decent work, "Vision" document*, ILO, 2006.

[4] See http://www.ilo.org/employment.

Foreword

Banks have become more aware of international labour standards, and in some cases are quite actively integrating labour standards principles into their investment decisions.

This paper examines current trends in the extent to which banks are addressing labour issues in their investment decisions. It looks at how banks actually integrate labour considerations into their risk management and provide information and support services to their clients. Lastly, it offers a critical assessment for what needs to be done for the banking sector to realize its potential as a force for promoting sustainable enterprises around the world.

The ILO Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy (MNE Declaration) is designed to guide private initiatives, both company policy such as codes of conduct for suppliers, and industry-wide initiatives. It is the only international CSR instrument which has the full backing of workers, employers and government. This tripartite origin makes it both highly credible and yet sensitive to the concerns of enterprises facing tough competition.

The MNE Declaration covers the fundamental principles and rights at work—concerning child labour, forced labour, freedom of association, collective bargaining, and non-discrimination—as well as wages, hours of work, and occupational health and safety. Some of the activities and initiatives of banks are focused on many of these issues and banks may find these principles to be a useful starting point for dialogue with companies and trade unions on how best to protect workers' rights while helping companies to retain, or even enhance, their competitiveness.[i]

David Lamotte
a.i. Director
Job Creation and Enterprise Development
Department

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Introduction

> "The reason there has been so much focus on banks and sustainability is because that is where the money is. Banks are perceived to have huge leverage with customers when they give out the money, so activists saw them as gatekeepers."
>
> Andrew Savitz, author of The Triple Bottom Line[5]

Banks are being watched, and increasingly feel the pressure. Bank profits have been rising substantially over the last decade, with a corresponding rise in expectations that they ensure that they are not profiting at the expense of workers, communities or the environment. Banks which may not have even heard of international labour standards just 10 years ago are becoming increasingly aware of the significance of violations of workers' rights as an important issue in their risk management. And trade unions, labour rights activists and NGOs on the ground are engaging actively to raise further awareness.

Financial institutions, both developmental and private, hold great potential for making a significant contribution to the creation of decent work, that is, more and better jobs for men and women everywhere; and for achieving the Millennium Development Goals. Banks are a critical source of capital for businesses to take root and grow. They have a powerful direct and indirect influence on expectations of company performance. They are also a critical ally because they invest directly in all industries and types of services and indirectly through financial institutions, in micro, small and medium enterprises. With this reach, they can help to spread awareness of the importance of sustainable enterprise development far beyond larger firms focused on export production.

In this paper we examine current trends in the extent to which banks are addressing labour issues in their investment decisions.[6] We also look in more detail at how banks actually integrate labour considerations into their risk management and provide information and support services to their clients. Lastly, we offer a critical assessment for what needs to be done for the banking sector to realize its potential as a force for promoting sustainable enterprises around the world.

[5] Quoted in "The importance of an ethical approach to project finance," *Financial Times*, London (UK) June 7, 2007, pg. 2.

[6] The treatment of workers who are employees of banks, while a very important area for research, is outside the scope of this paper.

DFIs: bridging workers' rights and banking

Development financial institutions (DFIs) are interesting hybrids in the banking world in terms of mission, capital, and clients. The International Finance Corporation (IFC), the private Sector arm of the World Bank Group, is the international DFI. Multi-lateral DFIs include the Inter-American Development Bank, the African Development Bank, the European Bank for Reconstruction and Development and the European Investment Bank, and the Asian Development Bank. There are many bilateral DFIs, such as FMO (Dutch) and DEG (German). And there are national development banks, such as BNDES, the Brazilian national development bank.

DFIs have the primary objective of demonstrating to financial markets that it is possible to invest in developing countries and still make a risk-adjusted profit. They also aim to make capital available for infrastructure and other projects to advance the development prospects of poor countries; and to help build up financial markets more generally through supporting national level financial institutions. The investments they make and stimulate help to create jobs, transfer technology and business knowledge, and thereby generate economic growth and social development.

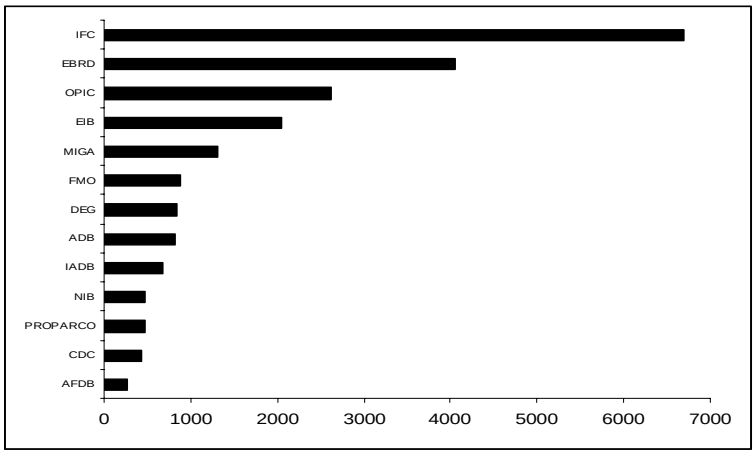
Unlike universal and commercial banks, DFIs have no depositors; their investment capital comes exclusively from their shareholders. For the multilateral DFIs, the member countries subscribe capital. For bilaterals, some are wholly owned by government, such as Deutsche Investitions und Entwicklungsgesellschaft (DEG), the German DFI, which is wholly owned by KfW bank group, which provides development loans to governments. Other bilaterals are partly owned by the private sector, such as Compañía Española de Financiación del Desarrollo (COFIDES), the Spanish DFI, which is 39% held by the three largest Spanish private banking groups.[7]

The specific portfolio varies by DFI, but typically includes loans, equity, structured finance and risk management products. DFIs invest in loans, equity, guarantees and other financial products; and provide a range of client support services. DFIs also typically provide substantial advisory services to build the private sector in developing countries.

Dellacha and te Velde (2007) find significant variation in the level of commitments, size of the portfolio, regional distribution, split in financial instruments, cash availability, returns on assets and equity. According to te Velde (2008), in 2005, total commitments to loans, equity and guarantees of the main regional, multi-lateral and bi-lateral DFIs totalled US$ 45 billion and US$21.3 billion of this went to support the private sector (See Chart 1).

[7] See European Development Financial Institutions website for further information: www.edfi.be

Chart 1: Commitments by DFIs to the Private Sector in 2005



Source: Dellacha and te Velde (2007), reproduced in Te Velde (2008)

The combined committed portfolio was US$ 182 billion in 2005. The sectoral distribution of investments also varies across DFIs. (See Table 1).

Table 1: Sectoral distribution of portfolio for IFC, EDFIs and EIB

	IFC (2007)	EDFI (2006)	EIB IF (2003-2006)
Financial sector	42%	47%	49%
Industry/Manufacturing	32%	23%	18%
Infrastructure	15%	21%	26%
Agribusiness	7%	4%	3%
Other	4%	6%	4%

Source: te Velde (2008) using data from EDFI, and IFC and EIB annual reports.

Note: IFC: industry/manufacturing includes global manufacturing and services and oil, gas, mining and chemicals. EIB: agribusiness estimated (and subtracted from industry data in annual report), IF is Investment Facility.

Investment of DFIs is going all over the world, but bilateral DFIs tend to concentrate on specific regions, as do most multilaterals. Bilateral DFIs focus on the private sector in developing countries, while the multilaterals tend to focus their business investments on sovereign loans for commercially run public enterprises. (te Velde, 2008).

Table 2: Geographical distribution of portfolio (% of total)

	IFC 2007	EDFI 2006
Sub-Saharan Africa (incl South Africa)	11	25
East Asia and Pacific (incl China)	14	15
South Asia	10	12
Europe and Central Asia (and "other" for EDFI)	28	25
Latin America and Caribbean	27	17
Middle East and North Africa	10	6
Total (%)	100	100
Size (volume, bn €), approx	19	12.3

Source: IFC annual report and EDFI (www.edfi.be), reproduced in te Velde (2008).

DFIs don't compete directly with private banks; rather, they serve to bring needed capital to countries and sectors where it is otherwise reluctant to go. This is done either through demonstration or partnership with private banks in syndicated loans. Table 2 shows the geographical composition of the portfolios of IFC and the EDFIs. The focus of DFI operations in developing countries, where jobs of a sufficient quantity and quality are most scarce, provides an important entry point for promoting decent work.

DFIs and labour issues

The focus of DFIs on economic and social development gives them more space (and arguably a greater obligation) to pioneer promotion of decent work in the banking sector and experiment with how it can be done in practice. Most DFIs, in particular the European Development Financial Institutions (EDFIs) and BNDES, are supported by governments which have strongly endorsed the Decent Work Agenda. Some, such as FMO and DEG have been early champions of the importance of fully integrating respect for workers' rights, in particular the core labour standards, in investment decisions and portfolio management.

As part of their development mission, the DFIs have in recent years begun to examine the environmental and social impact of their lending, including promotion of respect for workers' rights. ILO has been helping some of these banks with technical advice and assistance, such as jointly publishing with ADB a Handbook on Core Labour Standards. More recently, ILO has provided comments on the draft Performance Standards (PS) and Guidelines of the International Financial Corporation (IFC); and EBRD's environmental and social policy, which is currently being revised. ILO is also partnering with DFIs to address specific challenges, such as the Better Work partnership with IFC to support decent work at the country level in specific sectors, and providing technical assistance to EBRD concerning forced labour issues in the construction industry. Table 3 gives an indication of some of the activities multilaterals have undertaken recently concerning labour issues in investments.

Table 3: The Regional Multi-lateral Development Banks and Labour Issues

	Bank	Policy on Management of Social Issues
Europe	European Bank for Reconstruction and Development (EBRD)	EBRD Environment Policy, currently under revision Follows OECD Guidelines for Multinational Enterprises. Initial Environmental and Social Examinations (IESEs) EBRD Performance Requirements- (Labour and Working Conditions, Social Appraisal and Management, Indigenous Peoples, Information Disclosure and Stakeholder Engagement) Environmental and Social Action Plan (ESAP)
	European Investment Bank (EIB)	Core principles of Corporate Social Responsibility (CSR) at the heart of its strategy, objectives and policies EIB Social Impact Assessments EIB Sustainable Development and Environment Documents
Asian	Asian Development Bank (ADB)	ADB Social Protection Strategy (since 2001) Handbook on Poverty and Social Analysis (Section III Poverty and Social Analysis in Project Preparation) ADB's Safeguard Policies (indigenous Peoples: Policy on Indigenous People)
Americas	Inter-America Development Bank (IDB)	Managing Labor Issues in Infrastructure Projects Social Guidance for Private Sector Development "PRI" Projects Strategy and Policy on Indigenous Peoples The Fundamental Principles for PRI Projects related to environmental, social and health and safety aspects.
Africa	African Development Bank (AfDB)	*AfDB Social Audit Guidelines- AfDB Audit System*—procedure for the auditing process throughout the Bank project cycle. AfDB integrated social impact assessment guidelines Strategic Impact Assessment Guidelines Integrated Social Assessment Procedures for Private/Public Sector Operations Cooperation with Civil Society Organizations and Policy Guidelines

The IFC Performance Standards

IFC has had the greatest impact of the multilaterals in putting labour rights on the radar screen for banks, through adoption of the Performance Standards.

IFC's efforts in the area of non-financial risk date back to 1993 when it decided to follow the World Bank's approach to social and environmental policies.[8] In 1998, it began including some labour considerations, issuing a Policy Statement on Forced Labor and Harmful Child Labor, which was based on the ILO Forced and Compulsory Labour Convention, 1929 (No. 29) and the United Nations Convention on the Rights of the Child.[9]

Following some external and self-assessments of its social impact, IFC shifted in 2001 to a commitment to a triple bottom line approach balancing "people, planet, and profits." In 2003 the Compliance Advisor Ombudsman reviewed IFC's Safeguard Policies and identified gaps and deficiencies, including with respect to International Labour Standards. Pushed by NGOs and trade unions on the lack of social issues addressed by the existing Safeguard Policies, which was confirmed by the CAO report, the IFC decided to update them.[10] The IFC undertook over the next three years extensive consultations on both environmental and social policies with a broad range of stakeholders, including workers' and employers' organizations, and developed a new Policy on Social & Environmental Sustainability and Performance Standards and Disclosure Policy, which the World Bank Group Board of Directors approved early in 2006.

The IFC Policy includes requirements for IFC as an investor: its role and responsibility in supporting project performance in partnership with clients, its obligations to disclose information about itself as an institution and its activities, and its obligation to support IFC officers in implementing the Policy on Social and Environmental Sustainability and reviewing compliance and implementation by private sector projects.

There are also requirements for clients, contained in the Performance Standards included with the IFC Policy. Performance Standard 2 on "Labour and Working Conditions" establishes baseline working conditions and labour practices. While loans are not conditions on ex ante compliance with PS2, borrowers must show during the screening process that they will be able to meet them within a specified period of time and they must continue to meet these standards during the life of the project.

PS2 was drafted in consultation with the International Labour Organization, as was PS7 on Indigenous Peoples. The provisions of PS2 are guided by the ILO

[8]See, *Core Business: Achieving Consistent and Excellent Environmental and Social Outcomes*, IFC Compliance Advisor Ombudsman Report, January 2003.

[9] Ibid.

[10] Ibid.

Core Labor Standards[11] and other labour standards, as well as the United Nations Convention on the Rights of the Child (Article 32.1), and include the following elements:

- *Working Conditions and Management of Worker Relationship*
  - Human Resources Policy
  - Working Relationship
  - Working Conditions and Terms of Employment
  - Workers' Organizations
  - Non-Discrimination and Equal Opportunity
  - Retrenchment
  - Grievance Mechanism
- *Protecting the Work Force*
  - Child Labour
  - Forced Labour
- *Occupational Health and Safety*
- *Non-Employee Workers*
  - includes workers directly contracted or contracted through intermediaries; standard of "commercially reasonable efforts" applies.
- *Supply Chain*
  - PS2 applies to supply chain management in cases where low labour cost is a factor in the competitiveness of the item supplied.

Projects are classified as Category A, B or C depending on the potential environmental and social impact of the project (high, medium, or low, respectively). Risk is assessed taking into account the type, location, sensitivity and scope of the project. Category C projects, which have little or no anticipated

[11] Freedom of Association and Protection of the Right to Organise Convention, 1948 (No. 87); Right to Organise and Collective Bargaining Convention, 1949 (No. 98); Forced Labour Convention, 1930 (No. 29); Abolition of Forced Labour Convention, 1957 (No. 105); Equal Remuneration Convention, 1951 (No. 100); Discrimination (Employment and Occupation) Convention, 1958 (No. 111); Minimum Age Convention, 1973 (No. 138); and Worst Forms of Child Labour Convention, 1999 (No. 182).

environmental impact, require no further action beyond the initial screening. For all Category A projects and certain category B projects, the borrower must undertake an Environmental Impact Assessment.

Following the assessment, the borrower must create an Environmental Management Plan (EMP), based on the conclusions of the assessment. The EMP should address mitigation, formulate an action plan, and include monitoring and management of risk. The assessment and EMP for a Category A project is subject to independent expert review.

The new Policy and Performance Standards require greater consultations with affected stakeholders, not just during the screening process but also as the project unfolds, including a grievance mechanism to address community concerns. And they have expanded the grounds for review based on other human rights concerns, including adequate housing. IFC must be satisfied that the borrower or other relevant party has consulted with affected stakeholders; and the assessment must be publicly available for a reasonable time for comment in the appropriate language. Both the EA and EMP must take into account these consultations.

Obligations set out in the PS2 are covenanted into the loan agreement. Breach of these obligations may give rise to default after a grace period. However, banks must help the borrower to find solutions to bring it back into compliance with its obligations.

Performance Standard 2 has an accompanying guidance note which gives further details of what is expected of the client concerning labour issues. IFC established an Environmental and Social Review Procedure and a Quality Assurance System to manage the investment cycle from pre-appraisal to supervision; and established a new quality assurance team. It invested heavily in training investment and advisory staff, as well as specialized staff dealing with environmental and social issues. It also instituted a system for tracking information by internal and external stakeholders.

Warner (2006) stresses that the important feature of the new approach set out in the IFC Environmental and Social Policy and Performance Standards is a key shift: from minimum compliance to secure the loan, in which the client typically outsourced the task of demonstrating compliance to a consultant; to working with the client throughout the life of the loan, where the client has greater ownership of the process and greater commitment to positive outcomes.

IFC undertook an evaluation 18 months into the process of applying the new policy framework, based on a review of 250 projects which applied the Performance Standards. The review found that the new approach is working to strengthen projects. In assessing costs of imposing more stringent conditions on clients, IFC found the following:

> Despite concerns that the policy framework would be costly for IFC to implement, direct costs have been modest and spread over three fiscal years. Costs of project processing did not increase significantly, except for Category B projects; and this is consistent with the increase in IFC's overall cost of processing such projects. Among clients IFC has surveyed, 72 percent feel that the cost in meeting the Performance Standards would not impact their decision to return to IFC for financing. (IFC, 2007, p. iii)

IFC is confident that its approach adds not only development value, but also commercial value. IFC is exploring developing niche financial products for the market that exploit the quality of its portfolio as a result of rigorously applying the Performance Standards. (IFC, 2007)

The Multilateral Investment Guarantee Agency (MIGA), the arm of the World Bank Group which insures investments, has also recently adopted the Performance Standards for its operations. In addition, 32 export credit agencies of the OECD countries also benchmark private sector projects against the Performance Standards. The IFC Performance Standards have become the clear reference point for other DFIs because of the size of IFC which makes it very influential, as well as the fact that the Performance Standards are clear, well drafted and have supporting guidelines for implementation.

Bilateral DFIs addressing labour issues

Other leading DFIs concerning social issues, such as FMO and DEG, had advanced policies covering labour issues which preceded the adoption of the Performance Standards, and in some cases exceed them concerning labour issues which are more complex to assess, in particular respect for freedom of association.[12] Overall, however, the DFIs closely parallel the IFC concerning policy, but have far less resources to develop tools for implementation. Annex I indicates the labour issues covered by bilateral DFIs.

The DFI community is generally characterized by a balance between collaboration and competition. They share the same mission to contribute to economic and social development, and therefore are more willing to learn from and encourage each other to continuously advance in the area of social issues. For instance, each year about 10-15 social experts from various DFIs gather to present case studies on challenging issues, share experiences and provide encouragement to each other concerning labor and working conditions, community well-being and indigenous peoples' rights.

DFIs have an important direct role to play in promoting respect for workers' rights through their investments. However, their biggest impact is their influence on banking culture. Although DFIs have a distinct purpose from private banks, their for-profit operations, largely on competitive terms, makes it easier for private banks to understand and learn from DFIs. Private sector banks engaged in project finance like to lend with DFIs because their development mission brings a certain legitimacy to projects. With their unique links to government (as owners or clients) DFIs also can facilitate relations with government and NGOs in projects which are sensitive because of either their nature of scale. Additionally, because DFIs usually are linked to large governments, they have lot of bargaining clout private investors may not have, so borrowers may be more reluctant to default. These benefits are particularly important in project finance because it involves industrial projects (e.g., mines, pipelines), infrastructure (e.g., water, telecommunications) or privatization of state-owned enterprises—all of which may generate controversy; and almost invariably it is wholly non-recourse lending, which entails higher risks for the lenders. (Esty and Sesia, 2005, p. 1, cited in Scholtens and Dam, 2007).

[12] NB : for some DFIs their main function is to encourage home country investments in developing countries.

The Equator Principles: removing labour issues from competition in project finance

> "When [banks] started, they wanted something to fend off criticism. But pretty quickly, it became about how to have a management system for extra-financial risks….It is easier for companies to organize their management systems around a standard set of requirements that they know creates a level playing field. It is important for investors concerned about managing sustainability risks, who can tell capital owners that their investments are meeting a particular standard, and it is important from a transparency point of view—it gives a framework to report to your stakeholders how you are managing environmental and social risks."13
>
> Rachel Kyte, Director IFC Environmental and Social Development Department

The IFC Performance Standards and guidelines have become the key reference point for the banking sector concerning labour issues. They apply to private banks through the revised Equator Principles.

The Equator Principles (EPs) are a set of guidelines that are adopted voluntarily by financial institutions, referred to as Equator Principles Financial Institutions (EPFI). The original Equator Principles were adopted in 2003 by 10 banks, with assistance from IFC. They were designed to harmonize with the basic provisions of the IFC's then-existing lending policy in the area of project finance. They arose because some banks realized that having guidance and benchmarks for their project finance operations in non-OECD or low-income OECD countries would be a useful tool for them internally. In addition, for syndicated lending, which characterizes project finance, it is important that the banks around the table with the client have a sufficiently coherent approach to social issues so that they do not become an obstacle to lending. The EPs provide an agreed baseline. By 2006, the number of EPFIs grew to 40.

The Equator Principles were revised 2006 following the adoption of the new IFC Environmental and Social Policy and Performance Standards. The revised EPs again harmonize with IFC's approach, including implementing the same enhanced consultation procedure as IFC, and adopting the same screening criteria and requirements for independent review. The revised EPs also require EPFIs to establish a grievance mechanism. And the revised EPs require each EPFI to report publicly at least once a year about its implementation processes and experience,[14] although some critics, including Peter Woicke, former executive director of the IFC who was instrumental in working with the banks to

[13] Quoted in "This importance of an ethical approach to project finance", Financial Times, London (UK) June 7, 2007, pg. 2.

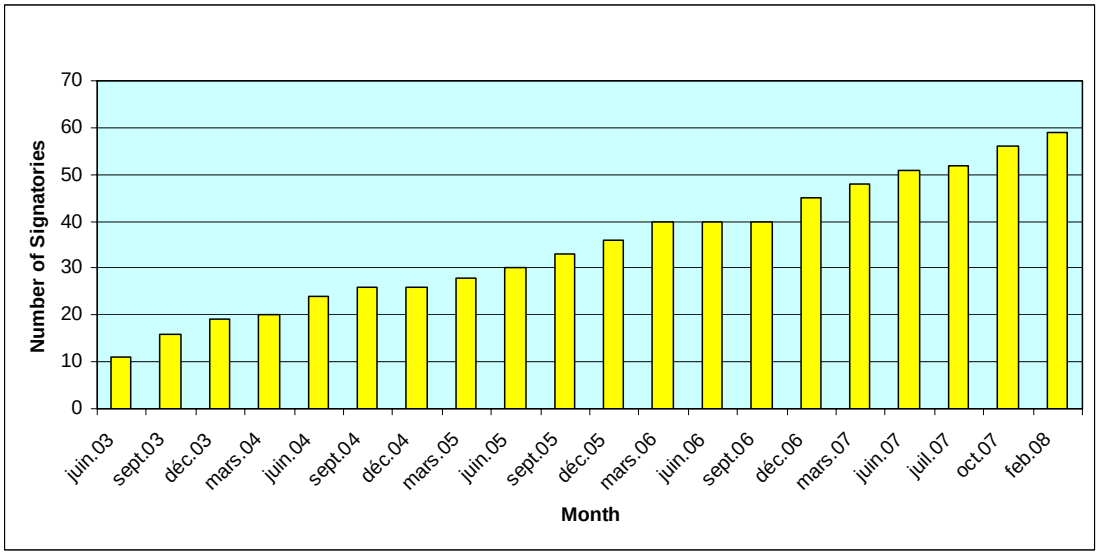
[14] The Equator Principles, A financial industry benchmark for determining, assessing and managing social and environmental risk in project financing. 2006.

http://www.equator-principles.com/documents/Equator_Principles.pdf

create the Equator Principles, feel that there is still a lack of transparency and accountability.[15]

Despite the more demanding requirements, EPFIs have continued to grow, reaching 59 as of February 2008. (See Chart 2)

Chart 2: Growth in number of institutions adopting the Equator Principles



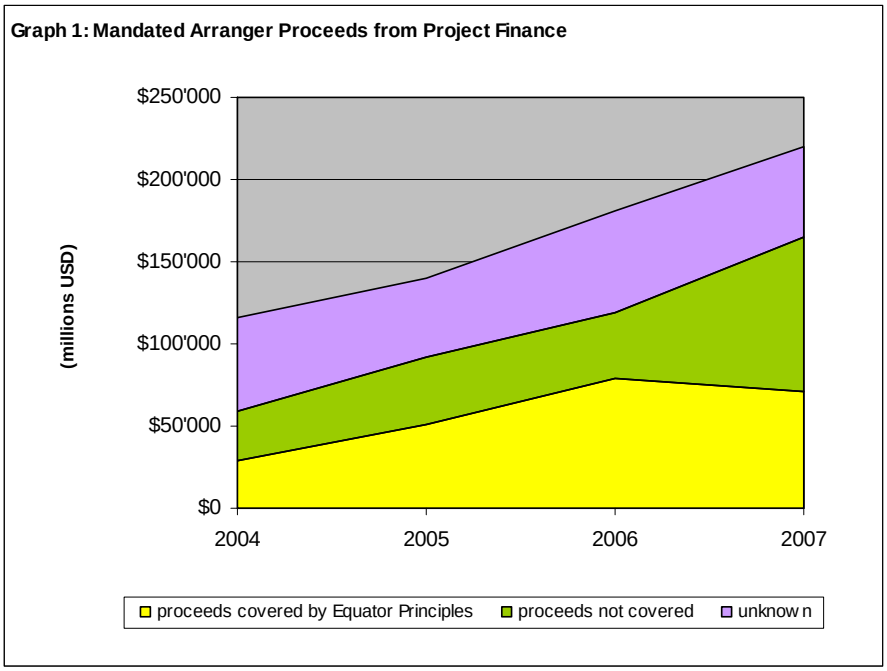
Source: chart based on information from www.equatorprinciples.com

The Equator Principles apply to project finance[16] where the total value of the project is at least $10 million (reduced from the previous threshold of $50 million). According to Esty et. al, the total amount of capital assets financed on a project basis grew at a compounded annual rate of 18% from 1996 to 2001, reaching a total of $217 billion in 2001; but still accounts for only 5% to 10% of total capital expenditures, however, the project finance accounts for a much higher proportion of the flows to developing countries. Project finance is concentrated in investment in large assets; Esty, et. al estimate that approximately half the capital assets costing $500 million or more were project financed. EPFIs account for approximately 85% of project finance flowing to developing countries. (Scholtens and Dam).

[15] Cited in "Radical and successful plan is not without critics" Financial Times, London (UK): June 12, 2006, p. 2.

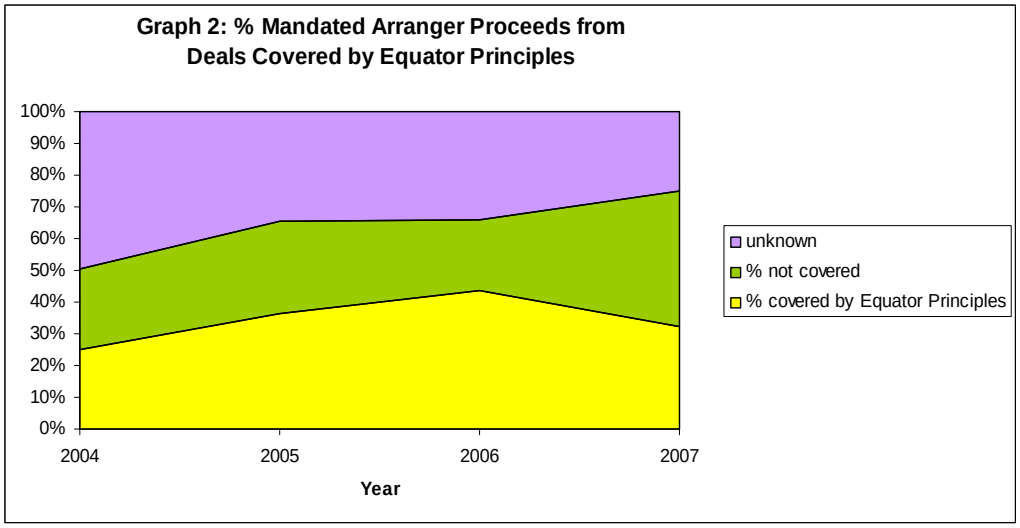
[16] Although the Equator Principles pertain to project finance, some financial institutions which do not engage in project finance, such as JP Morgan Chase, have adopted them, as have some national retail banks such as Unibanco.

Significantly, the revised Equator Principles also apply to project finance advisory services. The pivotal actor in project finance is the mandated arranger—the advisor who helps structure deals, raise capital and also puts up part of the capital. An important indicator of the spread of influence of the Equator Principles is the trend in uptake among the largest mandated arrangers. Graph 1 shows the proceeds of mandated arrangers for the period 2004 - 2007. The trend turned negative with the revision of the Equator Principles, indicating that the higher standards introduced in the revision have had some negative impact. However, it also indicates that the banks who likely do adopt the Equator Principles take them seriously.



Source: Calculations based on reporting from Thomson Financial

Another important indicator is growth in profits. Scholtens and Dam (2007) find that financial institutions adopting the Equator Principles carry some extra costs, compared with non-adopters. Graph 2 shows the percentage of Mandated Arranger profits from project finance that have been covered by the Equator Principles from 2004 to 2007.



Source: calculations based on information from Thomson Financial

Again, growth in percentage of proceeds covered by the EPs was negatively affected by the introduction of tougher requirements, indicating that there is indeed a cost to implementing the EPs. However, the continued growth of banks adopting the EPs also indicates that EPFIs consider that the cost is outweighed by the signal value of adopting the Equator Principles. This confirms the findings of an IFC Survey in which the most cited "key reason why banks consider environmental and social issues" was "increased credibility and gain in reputation." (IFC, 2007A) Although most of the period analyzed falls outside the adoption of the revised EPs, the finding accords with Scholtens and Dam's conclusions concerning the impact of the revised EPs: "adopting the EP is not window dressing, but exhibits real costs; and for larger banks, the benefits of signing up—which we think of as being reduced risk, albeit not observable in the financial data—outweigh these costs." (p.1318)

What EPFIs are doing in practice

The process prescribed in the revised Equator Principles is basic, with the intention that each EPFI adopt its own policy and procedures for implementation. Annex II provides an overview of what each EPFI is doing, and Table 4 gives an overview by region.

Table 4: Regional breakdown of banks adopting the Equator Principles

Regions	Number	UN PRI	UNEP FI	Social issues specified	Specific reference made to labour issues
Africa	1	0	1	1	0
Asia	4	1	3	3	0
Europe	30	6	17	14	3
Latin America	8	0	0	4	0
North America	13	1	11	11	2
Oceania	3	0	3	2	0
Total	59	8	33	35	5

Of the 59 institutions analyzed, 35 Equator Banks have instituted social issues in their lending policies or risk management system; and of these, the level of apparent commitment and mechanisms for implementation vary widely. For instance, some banks stated that they consider social issues in their operations management but without providing any publicly available policies or tools to manage these issues and risks.

It appears that EPFIs are acting on their general commitments under the EPs, through issuing statements, adopting policies, and developing some tools for implementation. And they are reinforcing those commitments with participation in complementary initiatives aimed at a broader range of investment activities, such as the UN Principles for Responsible Investment and UN Environmental Programme Financial Initiative. And ten EPFIs have joined the UN Global Compact, which refers to the core labour standards.

However, the picture starts to dim concerning workers' rights. The EPFIs generally use the terms "social issues" and "social policy" without specifically mentioning labour issues or specific tools to help them manage labour-related risks. Only 5 EPFIs specifically referenced labour issues, leaving room for doubt about whether they actually are doing much to take workers' rights into consideration. These finds accord with those of IFC: of the 121 responses to an IFC survey, 72% stated that health and safety of workers was a key risk facing their clients; but there was no mention of any of the other labour issues contained in Performance Standard 2, not even any of the core labour standards. (See IFC 2007A)

These findings indicate that, although the EPs require adopters to integrate the provisions of PS2 on labour issues in their policies, tools and risk management systems, the EPFIs have been relatively slow to do so, compared to other areas, in particular environmental risk management.

Challenges DFIs and EPFIs face in putting policies concerning workers' rights into practice

"Labour is going to give everybody a bit of a headache."[17]

Reed Huppman, Partner at ERM Consultancy

Most of the DFIs and EPFIs have policies to implement social issues, and a significant number have some tools to help put the policies into practice. Yet many still face significant challenges if they really want to make a difference in the lives of workers affected by their investments.

In order to understand these challenges ILO undertook semi-structured interviews with a total of 13 banks (See Annex III for list of banks interviewed), and tested the conclusions coming out of the interviews at a meeting of the EDFI banks. The findings indicate that, although all banks interviewed had a strong commitment to integrating labour considerations in their investments, even the most advanced banks faced numerous challenges, including the following:

1. *In most cases, implementation of social considerations still lags substantially behind environmental issues.* This is due to the historically greater emphasis given to environmental issues, the generally greater acceptance of environmental issues as an investment risk, and the relative difficulty of finding labour specialists on the ground who can support clients to undertake due diligence assessments, develop action plans, and conduct periodic monitoring. Currently, the responsibility for identifying concerns relating to workers' rights too often falls on the project engineer or project manager, who has no expertise in labour rights and industrial relations, or human resources management.
2. *Banks varied in their capacity to integrate labour considerations into their lending and project management.* Generally, larger DFIs had the greatest capacity, due to greater resources and the economies of scale they can achieve. Smaller DFIs and national banks, while often greatly committed, are generally struggling to find ways to collaborate to share tools and information, to bring down the costs and encourage more banks to take up labour issues. EPFIs rarely had any specialists with specific knowledge of labour issues.
3. *Banks have difficulty obtaining specific and credible information concerning labour issues.* In order to effectively integrate labour considerations into risk assessment, banks need to base decisions on credible information, which is often difficult to access. Even the most committed banks still face the challenge of accessing credible information on which to base their investment decisions. Such information is not always available. Some social experts within DFIs

[17] Quoted in Equator Principles: Revisions raise social hurdles, Financial Times, London (UK) June 9, 2006, p. 1.

and EPFIs are increasingly accessing websites of NGOs and the ITUC and local trade unions, but often the information is unreliable or incomplete. In addition to credibility, there is the issue of cost; it can be very labour intensive to gather this information. One large DFI urged development of a shared database of information to reduce costs, which others agreed would be very useful. A private market solution has already sprung up for China, where demand for information on labour issues is particularly high; but the database does not provide information on areas where law falls short of international standards. And such market solutions are less likely to develop for smaller countries which attract less FDI, and where the need for information may be the greatest.

4. *Banks need support and practical tools.* Investment officers are not labour specialists, and have no intention of becoming experts in labour issues; that is not their function. They need very simple yet effective guidance and tools to help them integrate labour considerations in their risk assessment and encourage their clients to fully comply with the lending requirements. Some DFIs and EPFIs have been able to develop labour-specific tools for bankers; but many others haven't, particularly the smaller banks. Furthermore, other bank staff also need support, such as legal officers drafting covenant agreements which reference provisions of international labour standards, and social experts dealing in greater detail with labour issues. So far, no market solution has arisen to meet these needs adequately.

5. *Banks need labour experts on the ground.* Bankers are the catalyst for change, but the most important change needs to happen within the client's operations on the ground, which requires effective local expertise in labour law, industrial relations, sector-specific issues, and human resources management. Local expertise is important to ensure there are no language barriers, to understand how principles contained in international labour standards and legal requirements under national law fit together, and to help build up local capacity for the longer term. Larger projects may be able to cover the cost of bringing in expertise from an international consulting firm; but smaller ones, which often are in greater need of support, have more difficulty covering costs. Some DFIs set aside money to cover the cost of supporting smaller clients who are less able to pay the fees foreign consultants charge, but most recognized that this is not an adequate solution to the problem of lack of local expertise.

Conclusion

The banking sector has potential as a vehicle for promoting decent work. DFIs have substantial influence with their clients because they do not compete with commercial banks, although they do compete to some extent with each other. The promotion of respect for workers' rights fits very naturally within their mission and mandate. All have policies which guide their investments, most of which cover social issues; and many of which directly address labour rights. A community of practice has also developed among DFIs around the Performance Standards which helps to build a culture of shared learning and a supportive environment.

The potential reach of DFIs is also significant. They apply their social policy to their whole portfolio which may include: project finance, loans to SMEs, investment in equity funds, and, most significantly, lines of credit to financial institutions in developing countries which, in principle at least, apply the same standards in their lending to micro and small enterprises. Although the capacity of DFIs to actually implement their policies varies, and is often weakest in the area of lending to financial institutions, many are taking steps to strengthen this component of their management of social risks. Consequently, DFIs have enormous potential as agents for change.

EPFIs have a great deal of potential influence because of the nature of project finance, and the fact that there is potential for the approach to spread beyond project finance. Pam Flaherty, senior vice-president for global community relations at Citigroup, explains: "Not only have we adopted the Equator Principles and helped create them, but we have also created a broader environmental and social risk management system which has happened in many other financial institutions as well. So we have had an impact even beyond the project finance." [18] Karina Litvack, Head of governance and sustainability investment at F&C, a UK fund manager, concurs: "You are now starting to see people within banks looking to spread the ethos of the Equator Principles beyond project finance".[19]

However, EPFIs for the most part have not yet taken adequate measures to implement the Equator Principles. To ensure a sufficient focus on labour issues, each EPFI should list labour rights as a distinct issue in its environmental and social policy, and commit adequate resources to implement the policy in their risk management, including developing systems and tools, providing staff with adequate training, and instituting a system for reporting on labour risks. The EPFI group is aware that labour issues are posing a unique set of challenges, and

[18] Quoted in "Radical and successful plan is not without critics" Financial Times, London (UK): June 12, 2006, p. 2.

[19] Ibid.

is now discussing ways to strengthen their capacity on labour issues, including possibly establishing a labour working group within the EPFIs.[20]

Watchdogs have emerged such as Bank Track which could help prod EPFIs to become more active on labour issues. However, with the exception of trade unions, most pressure groups are focused more on environment and the community aspects of social issues, and haven't yet engaged banks concerning workers' rights.

A more promising approach may be for the International Labour Organization, the UN Specialized agency responsible for promoting respect for workers' rights and growth of employment, to become more active in supporting EPFIs and DFIs. The International Labour Conference, the highest decision-making body of the ILO, has called on the Office to work more closely with international and regional financial institutions to help promote sustainable enterprise development.[21] ILO could help contribute to a better understanding of workers' rights among financial institutions by providing training and support to lending officers and lawyers drafting covenants; and providing more detailed technical support to social specialists. It could also help to boost the capacity of national experts dealing with labour issues. In addition, it could help to provide reliable information on labour issues by making available in simplied form the assessments of the Committee of Experts on the Application of Ratified Conventions and Recommendations of law and practice in countries which have ratified international labour conventions, and the information it has concerning labour legislation.

The ILO also could help to support workers and their organizations to engage more with Equator Banks, and raise awareness of the important role national employers' organisations can play as a source of support for clients. Lastly, ILO could help governments to understand the potential positive impacts on FDI of better protecting the rights of workers.

Through strengthening their efforts, and with support from ILO, the banking sector can be both socially responsible and profitable. And workers everywhere will benefit.

[20] Email communications with EPFI secretariat and chairs, November 2007 and February 2008.

[21] See, Report of the Committee on Sustainable Enterprises, International Labour Conference Provisional Record 15, Ninety-sixth Session, Geneva, 2007, p. 105.

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Glossary of Terms

ADB	Asian Development Bank
AFDB	African Development Bank
BNDES	Brazilian National Development bank
CDC	Commonwealth Development Corporation
COFIDES	Compania Espanola de Financiacion del Desarrollo (Spain)
DEG	Deutsche Investitions und Entwicklungsgesellschaft (Germany)
EBRD	European Bank for Reconstruction and Development
EDFIs	European Development Financial Institutions
EIB	European Investment Bank
EPs	Equator Principles
EPFIs	Equator Principles Financial Institutions
FINFUND	Finnish Industrial Development Fund
FMO	Netherlands Development Finance Company
IDB	Inter-American Development Bank
IFC	International Finance Corporation
IFU	Industrialiseringsfonden for Udviklingslandene
	(Industrialisation Fund for Developing Countries: Denmark)
NORFUND	Norwegian Investment Fund for Developing Countries
OPIC	Overseas Private Investment Corporation

Annex: Institutions Which Have Adopted the Equator Principles

ABN AMRO Bank, N.V.
ANZ
Banco Bradesco
Banco de la República Oriental del Uruguay
Banco do Brasil
Banco Galicia
Banco Itaú
BankMuscat
Bank of America
Bank of Tokyo-Mitsubishi UFJ
BMO Financial Group
Barclays plc
BBVA
BES Group
Calyon
Caja Navarra
CIBC
CIFI
Citigroup Inc.
CORPBANCA
Credit Suisse Group
Dexia Group
DnB Nor
Dresdner Bank
E+Co
EKF
Export Development Canada
Financial Bank
FMO
Fortis
HBOS
HSBC Group
HypoVereinsbank
ING Group
Intesa Sanpaolo
JPMorgan Chase
KBC
KfW IPEX-Bank
la Caixa
Lloyds TSB
Manulife
MCC
Mizuho Corporate Bank
Millennium bcp
National Australia Bank
Nordea
Nedbank Group
Rabobank Group
Royal Bank of Canada
Scotiabank
SEB
Societe Generale
Standard Chartered Bank
SMBC
TD Bank Financial Group
The Royal Bank of Scotland
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