

Responsible Banking

Working Paper 1



PARTNERS IN CHANGE
Promoting Human Rights in Business

Why be responsible? The case for being a good bank

August 2016

Rohan Preece, Partners in Change

Abstract

This working paper provides an overview of different expressions and drivers of responsible banking, before considering the moral argument for responsible banking. To be distinguished from other kinds of argument – such as the business or compliance argument – the moral argument is centrally concerned with why it is *right* for banks to be responsible. Various ways of substantiating the moral case are delineated, with reference both to principles and the more practical consequences of decisions that bankers make.

Contact: rohan@picindia.org

“The contribution of financial institutions including banks to sustainable development is paramount, considering the crucial role they play in financing the economic and developmental activities of the world. In this context, the urgency for banks to act as responsible corporate citizens in the society, especially in a developing country like ours, need be hardly overemphasized. Their activities should reflect their concern for human rights and environment.”

(P. Vijaya Bhaskar) Chief General, Reserve Bank of India, 2007¹

Introduction: expressions of responsible banking

Banks and financial institutions perform a wide range of activities, the nature of which differs from bank to bank, often for particular historic reasons as well as more immediate business reasons. ‘Banking’ as a term encompasses the various different services that a bank performs. Traditionally, the core business referred to accepting and storing depositors’ capital, and then lending this out at interest in order to generate a profit. Today, commercial banks continue to perform these and a range of other services, including providing financial

¹ <https://www.rbi.org.in/scripts/NotificationUser.aspx?Id=3987&Mode=0>

products. Many banks also invest, either as a specialist activity or alongside other commercial banking activities. These investment banks receive a fee from companies, governments, or other investors, in return for certain financial services, such as issuing and selling securities, or corporate finance of various kinds.

As the financial sector has mushroomed around the world in the era of globalisation, so have the models of responsible banking. Some banks have made being ‘ethical’ their USP, even advertising that they have rejected loan requests, and lost considerable income, in the name of principles. These ‘ethical banks’, such as Triodos and the Cooperative Bank, cannot compare to the most powerful and wealthy global banks in terms of size and influence. However, many of the very largest banks, especially in the West, and most particularly in Europe, are now claiming to be responsible corporate citizens, claims which they evidence by their commitments to international frameworks such as the UN Global Compact and the Equator Principles. Whilst some of these frameworks, such as the UN Principles on Responsible Investment, are normative – providing specific guidance, others, such as the GRI frameworks, call for banks, and other businesses, to report on policies and performance.

Table 1. A summary of key international principles, guidelines and standards for banks

Name	Core expectations
UN Guiding Principles on Business and Human Rights	Businesses should avoid contributing to adverse human rights impacts and also “seek to prevent or mitigate adverse human rights impacts that are directly linked to their operations, products or services by their business relationships, even if they have not contributed to those impacts.” (Foundational Principles, UNGPs). It also sets out expectations for, inter alia, board-approved policy commitments; due diligence on human rights (including assessment of actual and potential human rights impacts); stakeholder consultation; and remediation, whenever necessary.
GRI	Publishing of a sustainability report set up in accordance with the <u>GRI G4 Sustainability Reporting Guidelines</u> , including the <u>GRI Financial Services Sector Supplement (FSSS)</u>
<u>ISO 26000</u>	According to this standard on corporate social responsibility, CSR can be defined as the “responsibility of an organization for the impacts of its decisions and activities on society and the environment, through transparent and ethical behaviour that contributes to sustainable development, including health and the welfare of society; takes into account the expectations of stakeholders; is in compliance with applicable law and consistent with international norms of behaviour; and is integrated throughout the organization and practised in its relationships.” ISO (2010, November), <i>ISO 26000:2010 Guidance on Social Responsibility</i> .
<u>Equator Principles</u>	A risk management framework, adopted by financial institutions, for determining, assessing and managing environmental and social risk in projects
<u>IFC Environmental, Health and Safety Guidelines</u>	from the International Finance Corporation of the World Bank Group, these guidelines are designed to support effective management of environmental, health, and safety (EHS) issues and facilitate the inclusion of EHS considerations into business processes

UN Global Compact	Encourages businesses to meet some fundamental responsibilities in the areas of human rights, labour, environment and anti-corruption
UN Principles for Responsible Investment	Seeks to embed economic, social and governance imperatives into investments, decision-making and disclosure

Good banking governance has become more publically discernible with the recent trend towards increasing disclosure of lending and investment policies and practices. This has been accelerated following the 2008 financial crisis, which led to a huge loss of trust in the sector as whole. Greater transparency has been promoted by the Bank for International Settlements' Basel III framework², partly to ensure that risks are well understood by all key stakeholders. One distinction between the Basel III framework and other global frameworks on responsible investment is in terms of *who* is envisaged to be stakeholders. Whereas Basel III, a sector-driven framework, sees stakeholders as market participants - shareholders, investors, clients, and so focuses on *financial* transparency - frameworks such as the Equator Principles and the UNPRI envisage a widening of the stakeholder base to include local communities, and, with them, civil society and the wider public. This latter type of framework aims at a more holistic understanding of responsible banking that takes fuller account of risks across environmental, social and governance dimensions. Such risks, properly considered, are material to banks' lending and investment decisions. It follows that the banks' commitment to responsible risk management – especially social and environmental risks - should also be considered when making an ethical assessment about banks.

Here in India, actions and commitments that banks and other businesses have made to be responsible have largely been acts of compliance with the law. For example, Priority Sector Lending norms mean that all banks have to lend to the MSME sector, as well as to other target sectors such as education and housing³. Financial inclusion is also ensured by the Pradhan Mantri Jan Dhan Yojana (PMJDY) scheme, under which over 200 million previously unbanked citizens have been able to open bank accounts⁴.

In terms of risk management, the focus in India has been on business risks, whilst social and environmental risks have received relatively little attention. The neglect of these other kinds

² <http://www.bis.org/publ/bcbs286.pdf>

³ https://rbi.org.in/Scripts/BS_ViewMasCirculardetails.aspx?id=9046

⁴ <http://www.livemint.com/Politics/uhXJMepfwvOsWDHuRhj6I/Over-70-of-accounts-opened-under-Jan-Dhan-are-now-active.html>

of risks has been the subject of increasing scrutiny recently (PSA 2014⁵, CSE 2016⁶, Oxfam 2016⁷) and it is indeed possible to construct a sound business case for mitigating and managing risks to society and the environment.

Very much linked to the question of risk, though of still greater interest from an ethical perspective, is the question of accountability. Corporate Social Responsibility (CSR) in its full sense - understood as the commitment to respecting the triple bottom-line of people, planet and profit - is something that has been encouraged by the state through the National Voluntary Guidelines (2011) and the Business Responsibility Reporting (BRR) disclosure regime. Banks and financial institutions, which number 18 of the top 100 companies in India, have had to take steps to at least report on their commitments through BRRs. Responsibility to disadvantaged communities was also legislated by the State in 2013, but on this occasion it was a narrowly philanthropic form of CSR in 2013 which endorsed a particularist model of corporate responsibility focused on development beneficiaries.

In this context, banks have tended to focus their social efforts on areas such as those mandated and by the Companies Act legislation, and, indeed, on improving provisions for current and potential customers. A more universalistic and generous framing of accountability, and in which the bank posits and seeks to fulfil a wider set of accountabilities to a wider range of groups, including those impacted by entities that banks finance, is missing from the Indian landscape.

Why should banks be responsible?

In order to address this question, we will focus on universal banks (whose activities involve both commercial and investment activities). In our consideration here our focus is emphatically *not* on the business case for responsible banking: why it is in the interest of banks to be responsible. It will also largely eschew considerations of regulatory and legal compliance, which, again, can have an ulterior motivation (to avoid getting caught).

Rather, we wish to probe the moral case, an approach justified by the fact that this is an area in which, globally, ethics is way ahead of the law. Our approach will lead us to look at why it might be in the broader public interest for banks to be responsible, and why we should construe banks as morally responsible agents. As such, we consider a responsible bank to be one that meets each of the following three interconnected criteria:

⁵ https://www.academia.edu/10277966/Down_the_Rabbit_Hole

⁶ <http://www.downtoearth.org.in/news/banks-at-a-loss-53083>

⁷ <https://www.oxfamindia.org/impact-of-social-risk-on-indian-businesses>

1. It is **morally accountable**: the bank recognises its moral accountability for its lending and investments, and how they are used, and so takes care to exercise due control over these activities.
2. It upholds **core values of inclusion, equity and human rights**: the bank acts to promote inclusion, including financial inclusion, and to promote human rights, ensuring non-discriminatory practices within the workplace, and with respect to customers, local communities and businesses.
3. It is **transparent**: the bank proactively discloses financial matters and also about non-financial matters, notably environmental, social and governance criteria

We will now consider, in turn, reasons why a bank should be accountable, uphold core values, and be transparent.

i) ***The case for consequences: Why should banks be morally accountable?***

Decisions made within banks have the capacity to considerably impact the wider economy and society. This was indeed borne out by the 2008 financial crisis, which affected millions. In contexts where regulation is weak, inadequate, or opaque, or where human rights and are not universally respected, banks can also be complicit in abuse, in exploitation, and in violence.

As caretakers of enormous wealth, banks also have extraordinary power to do good. Banks can choose to invest in sectors such as renewable energy, and in companies that explicitly commit to human rights. The power to do good of course varies from context to context: in some cases, for example, banks would appear to only be able to choose from the ‘best of a bad bunch’: a company with a slightly better track record than others.

Core to a belief in banks’ moral accountability is the idea that they should share responsibility for activities that they help to fund. This notion of accountability recognises the decisive importance of financial capital in any business venture as well as the fact that banks have the *opportunity* to assess the merit of a particular loan or investment in advance. It is a conception of accountability strengthened by the fact that banks seek to extract profit from their loans and investments. If these loans and investments lead to negative and irreversible consequences for people and planet, and if the bank is aware (or has the opportunity to become aware) of the risks, then the profits will have been dishonourably earned.

Furthermore, given that a significant part of bank’s capital is that which has been entrusted to it by depositors, they also, it can be argued, have a relationship of trust with these depositors. Using funds that have been deposited for harmful ends may be seen as a betrayal of that trust wherever there are expectations to the contrary, eg in cases where the

depositor expects that it will not be misused. As custodians of capital banks also arguably do not have a right to misuse it, and instead have an obligation to communicate clearly how it will be used to their depositors (see ‘Transparency’ section below). This is a matter of honesty, and of integrity.

From a utilitarian perspective, banks, as co-architects and co-signatories of different kinds of business projects, should take good account of the consequences that flow from their decisions to approve loans and to invest in certain projects. There are numerous analogies appropriate here. In a court of law, manslaughter – unintentionally causing death – is taken extremely seriously and punished accordingly. And, to take a topical example, in the recent Iraq Inquiry, which assessed the run up to, duration and aftermath of the United Kingdom’s co-invasion of Iraq, deliberations about whether it was “right and necessary to invade Iraq in 2003” took account a variety of factors. These included the intent of doing so, the way the decision was taken (whether due process was followed) and also, crucially, the consequences that flowed from it. The Inquiry concluded that “despite explicit warnings, the consequences of the invasion were entirely underestimated.”⁸ All these three factors are acutely relevant in the context of projects that banks finance. Intention matters, but so does due process, as do the consequences – foreseen or unforeseen, intended or unintended.

As the financial system has evolved since the Reagan-Thatcher era, and banks have got larger and more powerful, their responsibilities have also grown. As Gert Wehinger of the OECD Directorate for Financial and Enterprise Affairs has argued, “banks are the caretakers of the financial system we all rely on, which is a responsibility that cannot be underestimated.”⁹ Clearly, the sector needs to be diligently and responsibly managed, “as risky investments and poor management affect not only banks and their shareholders, but society as a whole.” (EBAC 2014¹⁰)

ii) *The case for good citizenship: Why should banks uphold core values of inclusion, non-discrimination, equality and equity?*

Goal 1 and Goal 8 of the 2015 Sustainable Development Goals have, in their targets, brought financial services institutions into specific and explicit focus - with a stress on financial inclusion.

⁸ <http://www.iraqinquiry.org.uk/the-inquiry/sir-john-chilcots-public-statement/>

⁹ http://www.oecdobserver.org/news/fullstory.php/aid/4017/Banking,_ethics_and_good_principles_.html#sthash.f2EUE00U.dpuf

¹⁰ The 3Cs for Responsible Banking in Asia and the Pacific: Corporate Governance, Corporate Social Responsibility and Corporate Sustainability (United Nations ESCAP EBAC Business Advisory Council) http://www.unescap.org/sites/default/files/3Cs_handbook.pdf

Table 1. SDGs and Financial Inclusion

Goal	Target
Goal 1: End poverty in all its forms, everywhere	-Universal access to financial services, especially for excluded groups
Goal 8: Promote inclusive and sustainable economic growth, employment and decent work for all	-Accelerate growth of MSMEs through increasing access to financial services -Domestic financial institutions are enabled to expand access to banking and financial services for all

Source: Sustainable Development Goals¹¹

In India, the 2014 Pradhan Mantri Jan-Dhan Yojana (PMJDY) scheme has certainly widened access to banks and to finance, and Priority Sector Lending norms have helped to promote lending to some sectors that might otherwise have been neglected. But beyond the need to comply, what is the moral case for banks upholding the principles of inclusion and non-discrimination?

In an increasingly unequal world, banks do have a significant opportunity to make a difference to poorer and less privileged households and communities by ensuring that they have, at the very least, equitable access to the good quality financial services that they require. Banks also play an important role in the lives of customers, who are dependent on them for a range of services that they have reason to value. They are also, especially in large countries like India, substantial employers, whose workers depend on them for fair and non-discriminatory labour arrangements. Banks also have relationships with business partners across their supply chain and throughout their value chains, and in these relationships they have the opportunity, once again, to ensure that people are well-treated and looked after. Beyond that, in the lucrative partnerships that they form with businesses, they also have the opportunity to demonstrate commitments to constitutional values such as equality. In a highly iniquitous society, they have the choice whether to further this iniquity, or promote its reversal by ensuring that people are not exploited through projects they finance.

Ultimately, the reasons for banks – at the institutional level and at the most personal of levels - needing to promote respect for human dignity and the values that flow from it, lies in the potential human costs of them not doing so. As powerful corporate entities, they can do people tremendous harm as well as good. Further, as corporate Indian citizens, they should be bound by the provisions of the Constitution, no less than any individual citizen is.

¹¹ <http://www.un.org/sustainabledevelopment/sustainable-development-goals/>

iii) *The case for democracy: Why should banks be transparent?*

For most regulators and mainstream economists, transparency is a tool to bring greater efficiency and stability to financial markets. In contrast, for social justice advocates openness and visibility is a way to expose and counter financial practices which enable tax evasion, undue executive remuneration, money laundering, and other morally dubious conduct. For democracy promoters, transparency is an instrument that enables greater public participation and control in financial governance. For environmentalists, transparency is a means to identify and where necessary correct the ecological impacts of financial activities. So while many people want more transparency in financial markets, they want it for different reasons. Indeed, different kinds of transparency will serve different goals and benefit different constituencies. This makes transparency an object of considerable political struggle.

(Jan Art Scholte, University of Gothenburg/ University of Warwick, *Transparency: Sine Qua Non for Publicly Accountable Finance*¹²)

There is a significant disparity between the levels of disclosure of the largest international banks and those of India’s major banks. Indeed, the same can be said about Asia as a whole, where ESG disclosure is rather low. In its formulation of the Sustainable Development Goals, the international community recognised the need for more transparency and its importance in making institutions more accountable.

Table 1. SDGs and Financial Inclusion

Goal	Target
Goal 16: Promote peaceful and inclusive societies for sustainable development, provide access to justice for all and build effective, accountable and inclusive institutions at all levels	<ul style="list-style-type: none"> -Reduce illicit financial flows -Combat corruption and bribery -Develop accountable and transparent institutions -Ensure participatory decision-making -Ensure public access to information

Source: Sustainable Development Goals¹³

Transparency, which is most clearly visible in the practice of disclosure, can have different motivations, as neatly summarised in the above quotation by Jan Art Scholte. Our focus here, as already mentioned, is on the moral argument for transparency.

As Sholte has rightly diagnosed, transparency promotes democracy by bringing to light knowledge about how a bank is performing, financially and in other ways, and about its policies and systems. In taking information that might otherwise belong to a closed and private space into an open and public space (cf. Gaventa 2006¹⁴), it effectively represents a

¹² <http://fairfinanceguide.org/media/60730/joint-case-study-on-transparency-and-accountability-ffgi-150529-final.pdf>

¹³ <http://www.un.org/sustainabledevelopment/sustainable-development-goals/>

¹⁴ Finding the Spaces for Change: A Power Analysis John Gaventa, IDS Bulletin Volume 37 Number 6 November 2006 © Institute of Development Studies

handing over of power to those willing and able to scrutinise the information. With this power, information analysts are able to make inferences about a bank. This is useful not just for shareholders and investors – the market participants – but also for other citizens interested in knowing more about what banks and financial institutions are publically committed to. Such knowledge enables people who may not have a commercial interest in banks, but who are nonetheless implicated by their activities: local communities and the wider public, to hold them more effectively to account. It has facilitated initiatives such as the Fair Finance Guide¹⁵, which, now active in 9 countries, provides information on banks' policy commitments on a range of ethically relevant areas including arms, human rights, labour rights and environment. This information has allowed people in certain countries to change banks based on their perceived lack of ethical commitment.

Being able to hold powerful private institutions account for their attitude and behaviour towards people and the environment, or for corrupt practices, is a good thing, especially when it can be translated into positive behaviour change on the part of the institution. When it works well, it is democracy in action, enabled by transparency. When it works best, it actually contributes to the development of a more equitable society, in which people's rights are less likely to be trampled on in the name of business.

http://www.powercube.net/wp-content/uploads/2009/12/finding_spaces_for_change.pdf

¹⁵ <http://fairfinanceguide.org/>

References

Agarwal, N., Parvati, P., and Bhogal, R., Oxfam India, Impacts of Social Risks on Indian Businesses (2016)

Available at: https://www.oxfamindia.org/sites/all/themes/oxfamindia/images/Oxfam-Social-Report_19.04.16_final_for_print.pdf

Basel Committee on Banking Supervision Consultative Document Standards Review of the Pillar 3 disclosure requirements (2014), Bank for International Settlements

Available at: <http://www.bis.org/publ/bcbs286.pdf>

Bahaguna, K., Banks at a loss, Down to Earth, Tuesday 15 March 2016

Available at: <http://www.downtoearth.org.in/news/banks-at-a-loss-53083>

Bouslah, K.; Kryzanowski, L. and Mzali, B., Does Social Performance Affect the Risk of Financial Firms?, Working Papers in Responsible Banking & Finance, 4th Quarter 2012, Centre for Responsible Banking and Finance, University of St Andrews

Available at: http://www.st-andrews.ac.uk/business/rbf/workingpapers/RBF12_002.pdf

Carbon Disclosure Project and Risk Metrics Group, Best Practice in Climate Disclosure: Standards and Procedures for Comprehensive Reporting March 4, 2008 Meeting Report USA

Available at: <https://www.cdp.net/en-US/Results/Documents/Best-Practice-in-Climate-Disclosure-USA-2008.pdf>

EBAC, The 3Cs for Responsible Banking in Asia and the Pacific: Corporate Governance, Corporate Social Responsibility and Corporate Sustainability, 2014, (United Nations ESCAP EBAC Business Advisory Council)

Available at: http://www.unescap.org/sites/default/files/3Cs_handbook.pdf

Gaventa, J. (2006) Finding the Spaces for Change: A Power Analysis, IDS Bulletin Volume 37 Number 6 November 2006, Institute of Development Studies

Available at:

http://www.powercube.net/wpcontent/uploads/2009/12/finding_spaces_for_change.pdf

The Iraq Inquiry website

<http://www.iraqinquiry.org.uk/the-inquiry/sir-john-chilcots-public-statement/>

Nair, V., *Over 70% of accounts opened under Jan Dhan are now active*, February 29 2016

Available at: <http://www.livemint.com/Politics/uhXJMepfwvOsWDHuRhhj6l/Over-70-of-accounts-opened-under-Jan-Dhan-are-now-active.html>

Premkumar, L., (2014) Down the Rabbit Hole, PSA Research Collective

Available at: https://www.academia.edu/10277966/Down_the_Rabbit_Hole

Vijaya Bhaskar, P., Reserve Bank of India, Corporate Social Responsibility, Sustainable Development and Non-Financial Reporting – Role of Banks, December 20, 2007

Available at: <https://www.rbi.org.in/scripts/NotificationUser.aspx?Id=3987&Mode=0>

Reserve Bank of India, Master Circular - Priority Sector Lending-Targets and Classification, July 1 2014

Available at: https://rbi.org.in/Scripts/BS_ViewMasCirculardetails.aspx?id=9046

Scholte, J. A.,(2015), Transparency: Sine Qua Non for Publicly Accountable Finance, Chapter 9 in Transparency & Accountability in the Financial Sector, University of Gothenburg/University of Warwick

Available at: <http://fairfinanceguide.org/media/60730/joint-case-study-on-transparency-and-accountability-ffgi-150529-final.pdf>

UN Sustainable Development Goals

Available at: <http://www.un.org/sustainabledevelopment/sustainable-development-goals/>

Wehinger, G., Banking, ethics and good Principles, OECD Observer 294 Q1 2013

Available at:

http://www.oecdobserver.org/news/fullstory.php/aid/4017/Banking,_ethics_and_good_principles_.html#sthash.BmlYppLc.dpuf

