



Conflict Risk, Markets and the Bottom-Line

INVESTING IN STABILITY

“Thriving markets and human security go hand in hand. Global corporations can do more than simply endorse the virtues of the market... Their active support for better governance policies can help create environments in which both markets and human security flourish.”

Kofi Annan
Secretary General, United Nations

INVESTING IN STABILITY

A world on fire

The Social, Economic and Environmental Dimensions of Conflicts

UNEP FI and IISD are undertaking a project to better understand the positive and negative linkages between finance and conflict, and to explore the range of voluntary actions the financial sector could take to promote peace. This brochure summarizes insight gained through this initial scoping exercise. The project is funded by the German Environment Ministry.

“Careful and fair management of environmental resources is an important part of our peace policy for the future.”

Klaus Töpfer
Executive Director,
United Nation Environment Programme

Conflict is again at the top of the international policy agenda. A growing chorus of voices is appealing to the private sector to engage responsibly in zones of potential or open conflict. Attention is turning to the role of the financial sector, which through the facilitation of projects and resource flows can either foster social stability and peace, or trigger or sustain conflict.

Today's violent conflicts emerge primarily in underdeveloped regions. Civil war, terrorism, social unrest and armed oppression often have their roots in human insecurity and the competition over access to or control over valuable or scarce natural resources. They often arise in situations where projects or policies exacerbate existing divisions in society, often by undermining natural resource-based livelihoods.

Violence can be sparked by a range of social, economic or environmental triggers: an influx of refugees, a change in resource access rights, the collapse of a major industry or the onset of a severe drought. A development project can likewise cause conflict by changing the allocation of resources in a society. Violent conflict is often a symptom of the failure to achieve development that is both sustainable and equitable.



INVESTING IN STABILITY

Profits at risk

Why should financial institutions be concerned about conflict?

“Managers in multinational corporations find themselves operating in areas of armed conflict, indigenous cultural disputes, epidemic disease and other kinds of social upheaval... These new challenges will increasingly require business professionals to apply conflict resolution and peacebuilding strategies in situations where promoting peace is an essential element of successful business operations.”

Juliette Bennett
International Peace Forum

Throughout the financial sector, the effects of conflict and terrorism are becoming a serious concern. Bankers, asset managers and insurers are waking up to the possibility that violent conflict can pose tangible risks:

- **Ignorance of conflict-finance interlinkages can be expensive.** A small investment in better understanding now can reduce the risk of defaults or of unforeseen costs later.
- **Staying out is not an option.** Social stability is dynamic, and peace today may be conflict tomorrow.
- **Remaining neutral is an illusion.** Every investment decision changes resource allocation and thus affects the conflict dynamic. Companies, as well as the consortia of financing institutions, become part of the social context in conflict-prone regions.
- **Far-away conflicts can create local threats.** Unresolved local conflicts can spill over borders, and pressure is steadily rising on companies to take responsibility for their activities along global supply chains.
- **Conflict capacity could be a new source of competitive advantage.** Win-win opportunities, well understood in environmental management, remain underexploited in the field of social issues.
- **Conflict is high on the regulatory agenda.** A number of regulatory trends - against global terrorism and corruption, towards enhanced transparency and good governance - are creating new costs and challenges for the financial sector.
- **Conflict complicity is an emerging litigation risk.** Several multinational companies have faced legal challenges in cases where their operations abroad were associated with acts of violence and human rights abuses. Complicity could become a legal issue for financial firms in the future.
- **Conflict is an opportunity cost.** Political violence and insecurity are among the most important factors preventing investment in many countries. Moreover, conflict and instability in one country can spur financial flight and crisis across an entire region, and even unsettle the world economy.



INVESTING IN STABILITY

Facing complex challenges

Links Between Finance and Conflict

There are several means whereby firms in the finance sector can become entangled in conflict scenarios. This entanglement can be a consequence of:

- Investment in projects that undermine social stability, or that are located in conflict-prone areas;
- Misuse of financial services by insurgent or criminal groups, arms traders and corrupt officials;
- Contribution to social instability due to macroeconomic downturns that are exacerbated by large scale financial flows.

By taking preventative action on these fronts, the financial sector can help to stop violence and end destructive conflict.

The US Community Reinvestment Act

This law encourages federally-insured banks and thrifts to lend to low-and-moderate income areas. Banks are publicly rated on their community investment performance and those with good ratings are praised in the media and often receive additional benefits such as tax credits and government business. The few (about 2%) banks with poor ratings are precluded from corporate expansion, suffer from public naming and may face regulatory enforcement action.

How can financial institutions help to build sustainable peace?

Through a number of levers financial institutions can address political, economic, and social grievances that may be driving conflict, and lay the foundations for sustainable peace:

Core Business Levers

- Providing vital services for a functioning economy, which enable people to plan for the future and which generate employment;
- Catalysing foreign investment, financing the construction of critical infrastructure, and diversifying the economy through the provision of loans;
- Putting conditions on loans and insurance, insuring that projects are undertaken in a conflict-sensitive manner.

Policy Dialogue Levers

- Engaging in multistakeholder processes to promote protection of the environment, human rights, peace and other public goods.

Social Investment Levers

- Contributing to the reduction of and recovery from conflict by investing in community needs (e.g. reconstruction, education, humanitarian relief)
- Ensuring that this is done in a way that contributes to social capital and mutual interdependence (e.g. loans to small and medium enterprises and microcredits).

INVESTING IN STABILITY

Opportunities

The Potential Win-Wins for Finance and for Peace?

Shareholders Press Company to Adopt Human Rights and Conflict Assessment Standards

In early 2002, Real Assets Management Inc. and Meritas Mutual Funds filed a shareholder resolution calling on energy company Enbridge Inc. to enhance human rights protection in relation to its stake in a Colombian oil pipeline. In January 2002, Enbridge adopted the US-UK Voluntary Principles on Security and Human Rights, which include guidance on the contracting and training of security forces, and some key questions for carrying out a conflict assessment.

FTSE4Good Index Introduces Human Rights Criteria

In April 2003, investment index provider FTSE introduced criteria to screen resource extraction companies on the basis of their commitment to human rights in their policy statements, management systems and external reporting. Additional requirements are raised for firms operating in countries of higher risk. Commitments include: to respect core labour standards and other human rights norms, to monitor and address non-compliance, to consult with stakeholders, and to integrate human rights concerns into impact assessment processes.

Managers in the financial sector that act now to identify the opportunities and risks posed by conflict-business interlinkages will be better positioned to respond to emerging trends, and to identify opportunities for gaining competitive advantage:

Improved Risk Assessment

- Enhanced standards of 'due care' may have value if inserted in investment contracts for projects in zones of potential or open conflict.

New identifiers of high-performance investments

- Products or services which respond to conflict-related imperatives may yield above-market returns to the insightful investor.

New Products and Services

- There may be a market for professionally managed 'conflict-free' investment funds, or for venture capital funds that mobilise resources from wealthy diaspora communities for post-conflict reconstruction.

New Markets

- There is a potential first mover advantage for firms who make a bold early entry into a post-conflict economy.

Standard Chartered Bank to offer banking services in post-conflict Afghanistan:

**"We are a business, we seek to make a profit in time...
As we learn the market we will selectively start to be
involved in trade finance to help the commerce of
Afghanistan and its neighbouring trading partners."**

**John Janes,
Project Director, Standard Chartered**

INVESTING IN STABILITY

Partnerships

Working with the Financial Sector for Peace

The implementation of effective public private partnerships remains a major challenge, but some lessons can be drawn from existing initiatives:

Emerging Africa

Infrastructure Fund (EAIF)

Launched in January 2002, this public-private partnership aims to finance commercially viable infrastructure projects in Sub-Saharan Africa with a positive development effect. The consortium's main donor is the UK Department for International Development, with Standard Bank and Barclays contributing senior debt. Overall, \$305 million have been committed to the fund.

It is widely recognized that financial institutions could be vital actors in the prevention of conflict and the pursuit of peace. While there are attempts to engage the financial sector in the international peace agenda, little concrete guidance has emerged on:

- appropriate behaviour when the context of an investment changes from peace to conflict;
- engagement with companies operating in conflict zones;
- investment in post-conflict reconstruction.

Leading firms in the financial sector are already searching for appropriate benchmarks for the management of key conflict linkages.

Entry points for positive action in the finance sector at different stages of a conflict cycle

Conflict-prone

- Conflict indicators
- Understanding how finance and services can help enhance social stability
- Standards of "appropriate" behaviour

During Conflict

- Standards of "appropriate" behaviour (applicable norms, tools, laws and best practice)
- Good practice in controlling flows of finance into and out of conflict zones

Post-conflict

- Innovative financing for reconstruction
- Public private frameworks for investment (e.g. export credits and guarantees, tax credits)

Elements of a conflict-sensitive business approach for financial institutions

Banking

- Conflict impact assessment
- Conflict indicators
- Conditions on finance
- Disclosure rules
- Providing banking services in a way that enhances social stability
- Stakeholder consultation and policy dialogue.

Asset Management

- Conflict assessment
- Investment conditions
- Disclosure and Know Your Customer Rules
- Shareholder engagement with companies in a conflict zone
- Revenue transparency
- Stakeholder consultation and policy dialogue.

Insurance

- Conflict impact assessment
- Conflict indicators
- Public-Private collaboration to enhance risk-reward ratio
- Stakeholder consultation and policy dialogue.

INVESTING IN STABILITY

Investing in stability

A UNEP FI – IISD initiative supported by the German government



© UNEP Post Conflict Assessment Unit

Expert Workshop on Finance and Conflict September 5, 2003, London, UK

This meeting brought together representatives from the finance sector, governments, NGOs, and academia at HSBC headquarters. Its purpose was to better enable the development of relevant and practical proposals to the finance sector to maximize its contribution to conflict prevention and mitigation. Suggestions discussed at the workshop included, among others, tools for conflict assessment, guidelines for conflict management, and a compilation of case studies on good and bad practice in the finance sector.



© USAID

Ecology and Peace in Crisis-Prone Regions October 3-5, 2003 Loccum, Germany

The conference was an opportunity to present the first findings of UNEP FI's and IISD's research to a diverse audience of experts and stakeholders. The initial research findings were discussed and commented upon in a panel session and a workshop focused on the finance sector. Of special value was the international spread of participants at the conference, which allowed UNEP FI and IISD to gather a wide range of views and reactions, including strong perspectives from developing country representatives.



INVESTING IN STABILITY

The funding for the project Investing in Stability was provided by:

German Federal Ministry of the Environment, Nature Conservation and Nuclear Safety (BMU)

The responsibilities of the BMU include the environmental policy of the Federation, interdisciplinary issues pertaining to environmental law, health and the environment, nature conservation and the safety of chemicals and nuclear facilities. More information at www.bmu.de

The United Nations Environment Programme Finance Initiatives (UNEP FI)

UNEP FI is a unique global partnership between UNEP, and the private financial sector. UNEP FI works closely with approximately 275 financial institutions to develop and promote linkages between the environment, sustainability and financial performance. Through task forces, working groups, training programmes and research, UNEP FI aims to address the opportunities and needs that sustainable development can provide to the financial and subsequently the larger stakeholder community.

More information at www.unepfi.net or contact Mareike Hussels (mareike.hussels@unep.ch)



UNEP Finance Initiatives
Innovative financing for sustainability

International Institute for Sustainable Development (IISD)

IISD is one of the world's leading sustainable development policy research institutes. IISD facilitates collaborative policy research and advocacy networks spanning the North-South divide. In 2000 IISD and the IUCN, the World Conservation Union, established a Environment and Security Initiative with the aim of mapping out the links between natural resources and human security, and deriving practical tools for peacebuilding and natural resource management.

More information at www.iisd.org/natres/security or contact Jason Switzer (jswitzer@iisd.ca)

iisd

International
Institute for
Sustainable
Development

Institut
international du
développement
durable

The views expressed in this report are not necessarily those of UNEP or UNEP FI, or of its signatories, nor does UNEP FI or its signatories take any responsibility for actions taken as a result of views or opinions expressed in this report.
©2003 United Nations Environment Programme – Finance Initiatives