TRÓCAIRE Working for a Just World

JUNE 2010

Our pension, our future – the National Pensions Reserve Fund:

The need for policy reform to allow for a responsible investment policy that secures our future and is coherent with Ireland's international obligations.

Key points:

- The NPRF is legislatively prevented from implementing a responsible investment policy; a policy that will ensure long-term positive financial return whilst ensuring that the state is not at an unacceptable risk of being complicit in contributing to serious violations of human rights, severe environmental damage or breaches of international humanitarian law.
- Legislative changes are required; these should be underpinned by the UN Human Rights Council 'Protect, Respect and Remedy' (Ruggie) Framework, particularly as they relate to the need for due diligence mechanisms to be put in place to ensure the state is not at risk of complicity in serious rights abuses and damage to the state's reputation.
- The Minister for Finance should request the Irish Human Rights Commission to conduct research on this matter so that any legislative reforms proposed will be in line with Ireland's international commitments to the Ruggie Framework.
- The Minister for Finance should publish the 2010 report of the inter-departmental committee set up at his request to examine the issues of responsible investment for the NPRF to allow a broader public debate and engagement on these issues of wide public concern.
- As part of Ireland's commitment to ensuring policy coherence between its domestic legislation and its impacts on developing countries, the Inter Departmental Committee on Development (IDCD) should examine this report and consider how its conclusions will ensure coherence with Ireland's commitments to its international development policy obligations.

1. The role of the business sector and investors in low-income countries

Trócaire believes that business plays a pivotal role in the fight against poverty and has a crucial role to play in the development process through much needed investment, job creation and training. However not all such investments are uniformly positive. Trócaire's experience has shown that in countries with weaker governance structures, business actors, in particular trans-national corporations (TNCs) may in some cases play an unconstructive role, where they contribute to serious environmental degradation and human rights abuses. The growing reality for Trócaire and its partners in Latin America, Asia and Africa is that investments by TNCs in conflict or post-conflict societies, in particular for the extractives and mining sector are a cause of increasing social conflict and poverty.

This is borne out by the work of the United Nations (UN) Special Representative of the Secretary General (SRSG) on Business and Human Rights. The SRSG found that two thirds of TNC abuses he surveyed related to extractive and mining industries and primarily occurred in low income, post conflict countries characterised by a poor record on the rule of law.[1] He found that the extractive industries 'account for most allegations of the worst abuses, up to and including complicity in crimes against humanity'.[2]

A key factor underpinning such behaviour is the funding for TNC investments secured through the global financial marketplace. Since the 1990's there has been a significant growth in the number of sovereign wealth funds (SWF)[3] that are playing an increasing role in the financial markets. Their value in 2007 was put at US$2.2 trillion and this is estimated to rise to US$13.4 trillion within 10 years.[4] The Irish Government created a SWF titled the National Pensions Reserve Fund (NPRF) in 2000.

It is for these reasons that the responsible management and oversight of investments made by the state is a major development issue for Trócaire.[5]

This paper considers the current practices of the NPRF and proposes adaptations to these based on developments in thinking at the United Nations on the Business and Human Rights agenda and developments in practices on responsible investment. The paper concludes with a series of policy recommendations to advance reflection on these issues in Ireland.

2. The National Pensions Reserve Fund – Moves towards a responsible investment policy.

The NPRF was established in 2000 to provide supplementary funding for Ireland's current 'Pay as you go'[6] social welfare and public sector pensions from 2025 onwards. 1% of GDP is invested in the fund each year, currently the fund value stands at €24.5 billion.[7] This makes the state the largest single owner of capital in Ireland. The Government legislated that the mandate of the fund should be to operate on a strictly commercial basis to secure the best possible financial return. Since the inception of the NPRF, the state has been criticised for alleged complicity in human rights abuses committed by companies the NPRF has invested in. Investments in companies with operations allegedly complicit in abuses and conflict in countries such as Sudan and Zimbabwe have received particular attention.

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1 John Ruggie, "Interim report of the Special Representative of the Secretary-General on the issue of human rights and transnational corporations and other business enterprises", Economic and Social Council 62nd session, February 2006. Para 25 and 27.

2 Ibid

3 Sovereign Wealth Funds are investment funds under state ownership and control, composed of financial assets which can include: balance of payments surpluses, official foreign currency operations, the proceeds of privatizations, fiscal surpluses, and/or receipts resulting from commodity exports. The definition of sovereign wealth fund exclude, amongst other things, foreign currency reserve assets held by monetary authorities for the traditional balance of payments or monetary policy purposes, state-owned enterprises (SOEs) in the traditional sense, government-employee pension funds, or assets managed for the benefit of individuals. http://www.swfinstitute.org/

4 Lyons, G. (2007). State Capitalism: The Rise of Sovereign Wealth Funds. Journal of Management Research Vol 7, No. 3, December 2007.

5 Trocaire. (2009). The NPRF and Responsible Investment; Submission by Trócaire to the Inter Departmental Committee to Consider the appropriateness of an Ethical Investment Policy for the NPRF, June 2009. http://www.trocaire.org/sites/trocaire/files/pdfs/policy/NRPF%20and%20responsible%20investment.pdf

6 'Pay as you go' refers to funding each year's commitments from current exchequer revenues.

7 National Pensions Reserve Fund Quarterly Performance and Portfolio Update. 31 March 2010. www.nprf.ie

Case-study: Investment by the NPRF and its impacts on development.

Goldcorp Inc.[8] is undertaking gold mining in San Martin, Honduras. Goldcorp's practice of gold mining through open pit mining using cyanide heap-leaching[9] is considered responsible for severe water pollution, environmental degradation and serious health problems in the areas around the mine. Goldcorp's activities in San Martin were subject to fines by the Honduran Secretariat of Natural Resources for pollution and damage to the environment in 2007. Research carried out by the Honduran Department for the Environment in 2008 found high levels of heavy metals used and produced in the process of extracting gold, such as arsenic, lead and mercury, in blood samples taken from villagers living close to the mine. In 2007, the Latin America Water Tribunal ruled on a complaint filed by members of the Siria Valley communities, finding Goldcorp accountable for damage to the environment and unreasonable use of water in the Siria Valley.[10] Trócaire has been supporting a number of church organisations in Honduras over the last decade in their attempt to ensure that the extraction of gold in San Martin and elsewhere in Honduras is carried out in a responsible and fair manner, which does not incur human rights abuses and environmental degradation. These organisations, including the Diocese of Santa Rosa led by Bishop Santos, have reported harassment, intimidation, attempted kidnapping and death threats as a result of their work. The NPRF invests in Goldcorp.

The fund has worked to engage with these issues by becoming a founding member of the United Nations Principles for Responsible Investment (UNPRI). As part of this the fund has explicitly accepted that long-term financial returns are dependent on ensuring that environmental, social and governance (ESG) issues are integrated into investment decision making. As a result, the fund began in 2007, through an intermediary agency, to engage in active ownership activities with companies. These activities include amongst others, engaging companies in dialogue on ESG issues with a view to achieving better corporate performance and exercising its rights to vote at company AGMs. The principles underpinning such engagement have been designed by the intermediary agency rather than being based on international conventions that Ireland is a party to.

The NPRF's acceptance that ESG issues are material to financial returns and of the need to engage in active ownership is a welcome development as part of the NPRF's membership of the UNPRI. They do not however represent a comprehensive responsible investment policy in-line with evolving international best practice[11] and internationally agreed frameworks. There are three major issues that need to be addressed:

1. The active ownership work should be predicated on international conventions to which the state is a party to such as the OECD Guidelines for Multinational Enterprises.[12]
2. The state should not be investing in companies which produce weapons whose use violates international humanitarian law. In 2008, the state divested itself of companies who produced cluster munitions arising from its signing of the Cluster Munitions Treaty ban. The precedent has been set and should now be applied to nuclear weapons given the state's policy on promoting a nuclear-weapon free world.[13]
3. The state has a duty to protect human rights. This requires it to put in place due diligence mechanisms that ensures the state is not at risk of complicity in serious rights violations through its investments. Much progress has been made at the UN in defining the concepts of due diligence and complicity within the mandate of the UN SRSG.[14]

In 2009, the Minister for Finance established an inter-departmental committee to examine the issues. This committee provided its report to the Minister for Finance in 2010 and this report has yet to be made public.

3. The Global Context

In the last few years there has been heightened international engagement on the role of business in society[15] and related rapid growth in Socially Responsible Investment (SRI) funds.[16] It is estimated that in Europe alone over €2.6 trillion are channelled through such funds.[17] Related to this the Global Corporate Citizen Initiative of the World Economic Forum has identified that the major beneficial owners of the world's largest companies are now the huge majority of working people whose pensions and other life savings are invested in these companies. If their interests are to be served, investment managers must take regard to the long-term health and vitality of their countries' economies, societies and environments.

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8 Goldcorp Inc, a Canadian registered company, acquired Glamis Gold Inc. in November 2006.

9 Cyanide heap-leaching is an industrial mining process whereby gold is extracted from low-grade deposits inexpensively using irrigation and chemical compounds such as cyanide. Piles of crushed gold ore are soaked in a solution of cyanide which filters down leaching out the gold deposits and releasing other toxic heavy metals such as arsenic, mercury and lead.

10 'San Martin mine in the Siria Valley, Honduras - the issues', CAFOD, April 2009 and 'Mining for Justice: The struggle of Honduran civil society for responsible mining', Canadian Catholic Organization for Development and Peace, September 2007.

11 Cumming, M., (2009). Responsible investment and its place in development: Challenges for the Irish National Pensions Reserve Fund. Trócaire Development Review, 2009. http://www.trocaire.org/sites/trocaire/files/pdfs/tdr/Responsible%20Investment%20and%20its%20Place%20in%20Development.pdf

12 Ireland is a party to the OECD Guidelines for Multinational Investment which outline expected corporate behaviour of OECD based companies in other countries around the world. The guidelines are available at: http://www.oecd.org/dataoecd/56/36/1922428.pdf

13 Omnibus resolution, 'Towards a nuclear-weapon-free world: a new agenda' tabled in 1998 by the New Agenda Coalition, consisting of Egypt, Ireland, Mexico, New Zealand, Sweden and Brazil, included A/C.1/53/L.45, 'Follow-up to the advisory opinion of the International Court of Justice on the Legality of the Threat or Use of Nuclear Weapons'.

14 Ruggie, J. (2008). Report of the Special Representative of the Secretary-General on the issue of human rights and transnational corporations and other business enterprises. Human Rights Council Eighth session A/HRC/8/5

15 Ibid

16 Guay, T. et al. (2004). Non-governmental organizations, shareholder activism and Socially responsible investments: Ethical, strategic and governance implications. Journal of Business Ethics, Vol. 52, No. 1, Special issue on Ethical Investment and Corporate Social Responsibility (June 2004), pp. 125-139

17 Eurosif (European social investment forum) (2008) European SRI Study. Eurosif: Paris.

The issue of responsible investment has received a further boost within the current processes underway on business and human rights in the UN. In 2005 the UN Secretary General appointed John Ruggie as UN Special Representative of the Secretary General on Business and Human Rights. Ireland, in its position as President of the EU in 2004, played an important and supportive role in the creation of this mandate.[18] His first mandate concluded in 2008 with the adoption by the UN of his 'Protect, Respect and Remedy' framework. He secured a second mandate that runs till June 2011 within which time he is working on further operationalising this framework.

To frame and regulate the relationship between businesses, the state, and communities the framework lays out three broad principles. Firstly, there is the need to ensure that states fulfil their duty to protect citizens against human rights abuses by companies. Secondly, the need for corporations to respect human rights by including human rights perspectives in their policies, in particular developing and conducting human rights due diligence. Finally, the SRSG proposed more effective access to remedies through various judicial and non-judicial grievance mechanisms to provide redress to those negatively impacted by TNCs.

4. The State Duty to Protect

The first element of the SRSG framework - the state duty to protect citizens - is the most salient for the challenges faced by state managed funds in creating a responsible investment policy. The state duty to protect is an obligation of conduct, not result. States are not automatically responsible for abuse by a corporation that is not acting under their control. However, they do have a responsibility to implement systems of due diligence to prevent, investigate, punish, and provide redress for rights violations by all types of corporations.[19] A key aspect of an effective due diligence process is the avoidance of complicity.[20] In the business and human rights context complicity refers to the indirect involvement of companies in human rights abuses. Supporting this, the Graver Committee, established by the Government of Norway to develop ethical guidelines for the Norwegian Pension Fund, found that "owning shares in a company that can be expected to commit grossly unethical actions may be regarded as complicity in these actions".[21]

The SRSG identifies that the "fostering of a corporate culture respectful of human rights at home and abroad should be viewed as an urgent policy priority for governments - necessitated by the escalating exposure of people and communities to corporate-related abuses".[22]

Referencing state sovereign wealth funds (such as the NPRF), the SRSG notes that any human rights harms caused through acting on behalf of or under orders from the state reflects directly on that state's reputation. There is, he asserts, an incentive in the national interest to exercise greater oversight.[23] Additionally, governments should not assume they are helping business by failing to provide adequate guidance for, or regulation of, the human rights impact of corporate activities. On the contrary, the less governments do the more they increase reputational and other potential risks to business such as litigation and loss of investors.

The EU has as part of the Human Rights Council supported the adoption of the Ruggie Framework. The issue of Business and Human Rights has been part of both the Swedish and Spanish presidencies of the EU. The Swedish presidency hosted a conference in November 2009 focused on the Ruggie framework. In its concluding statement the Swedish presidency of the EU and the incoming Spanish presidency encouraged all Member States to emphasise the importance of fulfilling human rights within government controlled processes.[24]

5. Opportunities and challenges

In establishing the NPRF, Ireland became the first EU state to have a SWF. SWFs have been around since the 1950's, the earliest being the oil funds created by the Gulf States. Increasingly since that time, states have established such funds to typically manage natural resource wealth (such as oil). In Ireland's case the proceeds of the sale of Eircom were used to launch the fund to which 1% of GDP has been added every year since. The only other SWF in the EU is in France. It was established in late 2008 with a particular mandate to invest in French owned companies and ensure they do not fall into foreign ownership.[25] In that respect the French SWF is controversial and differs from most other SWFs which invest most of their funds outside their national economy. The only other European SWF that Ireland can look to for some manner of guidance on how to deal with the issues of responsible investment is the Norwegian Government Pension Fund referred to as the 'Global Pension Fund – Global' (GPFG).

[18] Ireland negotiated and presented the Commission on Human Rights Decision 2004/116 requesting the Office of the High Commissioner for Human Rights to compile a report setting out the scope and legal status of existing initiatives and standards relating to the responsibility of transnational corporations and related business enterprises with regard to human rights. This report formed the basis for the establishment of SRSG mandate in 2005.

[19] John Ruggie. (2008). "Report of the Special Representative of the Secretary-General on the issue of human rights and transnational corporations and other business enterprises", Human Rights Council Eighth session A/HRC/8/5 (7 April 2008), Para. 18,82 and 83.

[20] Ibid. Pg. 20

[21] Graver Committee. 2003. "The report from the Graver Committee." Ministry of Finance, Norway. http://www.regjeringen.no/nb/dep/fin/tema/statens_pensjonsfond/etiske-retningslinjer/graverutvalget/Report-on-ethical-guidelines.html?id=420232

[22] John Ruggie, "Report of the Special Representative of the Secretary-General on the issue of human rights and transnational corporations and other business enterprises", Human Rights Council Eighth session A/HRC/8/5 (7 April 2008). Para 27, Pg. 9.

[23] Ibid, Para 32, Pg. 11.

[24] Swedish Presidency of the European Union, November 2009. Protect, Respect, Remedy – Making the EU take a lead in promoting Corporate Social Responsibility

[25] Kavaljit Singh in Resource Investor. (2009). Europe doesn't need sovereign wealth funds. http://www.resourceinvestor.com/News/2008/11/Pages/Europe-Doesn-t-Need-Sovereign-Wealth-Funds.aspx

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The GPFG has two operating principles; firstly to secure profitable long-term returns for the benefit of future generations, while secondly, to avoid risk of complicity through investment in companies engaged in actions contrary to the values of Norwegian society. As part of this it chooses to avoid those investments which either are contrary to Norway's international obligations (e.g. cluster munitions and nuclear weapons) or its domestic ethics (e.g. tobacco production) and to set aside a percentage of its fund for focused investment in new green technologies. To deliver on what is internationally recognised as a comprehensive responsible investment policy it utilises two broad measures. The first involves a focussed programme of active ownership based on the UN Global Compact and the OECD guidelines for Corporate Governance and for Multinational Enterprises. Through this active ownership the fund actively seeks on its own and in collaboration with other investors to influence company and industry behaviour to improve performance across the ESG spectrum. Its second mechanism is to avoid risk of complicity in abuses. To this end it has a Council on Ethics which conducts investigations of company abuses and determines whether continued investment will lead to an unacceptable risk of the Norwegian state being complicit in gross abuses.

These twin mechanisms were the subject of an international review in 2008.[26] The general conclusion was that these had worked well and were fulfilling their purpose as originally intended.

The exclusion of investments due to risk of complicity carries significant weight as it carries with it the sanction of the Government of Norway. During the international review of the mechanisms there was much discussion as to the relative role and place of active ownership and divestment. It is argued that as soon as divestment occurs there is no further possibility to influence. However the Norwegian Government has emphasised that the option to divest is a last stage option. It is to be used following the failure of active ownership to produce the hoped for change thereby leaving the Government with no choice but to divest so as to avoid it being at risk of future complicity of abuses.[27] New guidelines on the linkages to be made between active ownership and divestment were published in March 2010.[28] These provide for greater information sharing between the two mechanisms and for the creation of a stage prior to the implementation of divestment that involves putting companies on a public 'observation' list.

These two guiding principles, long-term profits without complicity in abuses and the four-pronged framework of active ownership, exclusion of certain investments, avoidance of complicity and targeted green investments deserve close examination by Ireland at this time of reflection on the future nature of a responsible investment policy for the NPRF.

In an increasingly fragile world with growing concerns for the sustainability of our economies and ecology, investors will play a crucial role in setting priorities for business. This is increasingly evident following the financial crisis where many questions are being asked around the ethics, standards and regulations governing the market. This presents a key opportunity for reframing the rules and standards around international investment policy. Building on UN frameworks on business and human rights and models currently in existence in other countries, there is now an opportunity to redraw the investment landscape and demonstrate a commitment to long-term sustainable development. This would promote standards of behaviour and operation that reflect the desire of the great majority to see a globalisation built on respect for human rights, the environment and international humanitarian law. In that regard a comprehensive responsible investment policy makes business sense in ensuring the longer term sustainability of our societies while being done in such a way that is congruent with our international obligations to uphold international human rights and humanitarian law.

6. Recommendations

Trócaire believes that further research into these issues is necessary by competent state institutions to ensure that a proper backdrop is given to any policy framework that will underpin the reform to the NPRF investment policy and subsequent legislation that will clearly be needed. In particular Trócaire would recommend:

- The Minister for Finance should publish the 2010 report of the inter-departmental committee set up at his request to examine the issues of responsible investment for the NPRF to allow a broader public debate and engagement on these issues of wide public concern.
- The Inter-Departmental Committee on Development (IDCD) should examine this report and consider how its conclusions will ensure coherence with Ireland's commitments to its international development policy obligations.
- The Minister for Finance should engage the Irish Human Rights Commission (IHRC) on this issue. The IHRC has jurisdiction to promote and protect human rights as defined by both domestic legislation and international agreements to which Ireland is a party to. It is equipped to review law and practice, to consult with national or international bodies or agencies and to make recommendations to the Government. As part of this mandate it should conduct a review of the state duty to protect human rights as determined by the internationally agreed Ruggie Framework and research what investor due diligence practices look like that would satisfy this state duty.

[26] Albright Group and Chesterman S. (2008). Assessment of Implementation of Articles 3 and 4 of the Ethical Guidelines for the Government Pension Fund – Global. Norway Ministry of Finance. [http://www.responsible-investor.com/images/uploads/resources/research/21214492869Albright_Group_Ethical_Guidelines.pdf]

[27] Norway Ministry of Finance. (2010). New guidelines for responsible investment practices in the Government Pension Fund Global. Press release number 11/2010, 2nd March 2010. Available at http://www.regjeringen.no/en/dep/fin/press-center/Press-releases/2010/New-guidelines-for-responsible-investment-practices-in-the-Government-Pension-Fund-Global-GPFG.html?id=594246

[28] Norway Ministry of Finance. (2010). Guidelines for observation and exclusion from the Government Pension Fund Global's investment universe. Available at http://www.regjeringen.no/en/sub/styrer-rad-utvalg/ethics_council/ethical-guidelines.html?id=425277

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