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BUSINESS EUROPE

Open Season

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Hug a banker. Yes, they get some meaty bonuses. They are also beginning to get some grief.

It started with project finance. If they did a massive pipeline that looked a little dodgy -- smack through a rainforest, say, or requiring the resettling of an uncontacted tribe -- they could expect a certain amount of NGO heat. That was a time of innocence: cucumber sandwiches, crustless, on the croquet lawn of civil society. Now it's open season.



Take the case of "Shake-N-Go" real-hair wigs, a provider of quality follicle-based solutions that happened to have a remarkably low-cost Chinese supplier of the raw material (hair). Why so low-cost? Well, reported the South China Morning Post, this is just the sort of cost advantage you may have if you're using a touch of prison labor -- in this case, allegedly, Falun Gong religious detainees at Henan County Rehabilitation and Re-Education Camp 3.

These are horrific allegations. But just whom did the media and NGOs focus on as a target? Not the company, nor its suppliers, but the banks. A load of beautiful blue-chip banks -- whose names I won't mention for the excellent reason that some of them belong to that elite group of not-yet-former clients. Why were they targeted? For holding shares, as nominees on behalf of investors, in

a company, one of whose many suppliers may have been, unbeknownst to any of these banks, using prison labor for part of its operations. Think of it. One day you're sipping Frappuccinos in the City, passing around the canapés. Next thing you know, you're the target of an Amnesty International human-rights inquiry into labor abuses.

But what is the real impact on a bank -- a great deposit-taking bank -- from a pressure campaign of this type? Forget credit risk or legal risk. Let's look at the brand. What holds a great bank together? What is the one emotion you as the depositor must feel toward your bank? In a word, trust. When you give a bank your savings, you are putting your life in their hands. What's more, they are unverifiable; you can't kick the tires. A bank is nothing more than an accumulation of individual credits, each of them of continuously shifting asset quality (coupled with an interesting propensity to collapse wherever the IMF and World Bank implement their financial-sector

stabilization plans). It's not that banks are black boxes. They are risk soup. Potage de risque. Risk-zuppen.

So what are the impacts on trust of these "Shake-N-Go" campaigns? When a bank gets accused of financing prison labor, the depositor can draw only two possible conclusions. Either this is an amoral group that doesn't have any policies (run screaming), or it does have policies but just doesn't bother to implement them (quietly find the exit). Either way, the bank gets brand suicide. Franchise Fallujah. And with equally little apparent exit.

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The world's biggest banks thought they had taken care of this problem. Back in 2003 ABN Amro, Barclays, Citi and WestLB got together to create the Equator Principles, a common approach for dealing with environmental and social issues in big-ticket project financing (deals with a total cost of \$50 million and over).

The Equator Principles had two interesting features. First, they were based on the internationally accepted standards of the World Bank. They had the approval of all but the most radical, bark-nibbling elements of civil society. Second, they weren't the usual, unverifiable "aspirational statements." They had specific standards: Does the project affect critical natural habitats? Are indigenous people involuntarily resettled? These standards meant that you knew, as a client or as a banker, that as long as the deal didn't violate the core standards of the Equator Principles, you would be OK. You could plan, you could predict, you could mitigate to ensure compliance and approval. You could get the deal through.

That was the theory, and it was just starting to work. The number of Equator Principles adopters grew from the founding four to 53 today, collectively covering more than 85% of global project financing. For those banks that implemented the Principles, the reputational lid was finding its way back on the box.

Then came carbon -- the perfect storm, combining reputational, credit and legal risks.

Take Texas Utilities, a series of 11 new coal-fired power plants with estimated annual CO2 emissions of 78 million tons. To put that in context, it's equal to about 80% of Britain's emissions reduction target under the Kyoto Protocol. Even though these plants had been approved by Texas authorities as part of a strategy to reduce the number of brownouts in the state, they became a pressure-campaign magnet -- and the banks were the ones fingered in the suspect lineup created by the media and the likes of Rainforest Action Network.

Then consider the dilemma faced by OPIC, the Overseas Private Investment Corporation, and Ex-Im, the U.S. Export-Import Bank. They now face a lawsuit filed by Greenpeace, Friends of the Earth and four U.S. cities -- spearheaded by the City Council of Oakland, California. The lawsuit claims that 8% of all the world's greenhouse gases come from projects supported by these two agencies, and that the banks are therefore liable for the climate-change impacts on those cities. The federal court for the Northern District of California recently allowed the lawsuit to proceed.

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For CEOs, a new geography of risk appears to be emerging, a change in the very nature of regulation. Governments are being joined, and in some cases replaced, by a new cohort of self-

appointed, informal regulators -- from project-affected peoples and the municipality of Oakland to "socially responsible" pension funds, NGOs and the global media.

With that as the reality, the fundamentals of compliance are shifting. These private regulators have their own rules and their own sanctions, a set of pressure techniques from customer boycotts to divestment campaigns that enable them to force what was previously a social or environmental externality onto the corporate balance sheet. So long-term compliance is not just about getting the permit these days. It is about getting stakeholder buy-in.

How are banks and companies dealing with this shift? One principle is common: Consultation (not, alas, consultants) is king. It is not just about buying an off-the-shelf solution. It's about engaging, with commitment from the top: talking to key stakeholders; finding out their concerns, from cluster bombs to the social impacts of biofuels; and then translating those concerns into a set of practical policies that the institution implements, allowing it to make deals work on the ground for the bank, for the client and for the affected communities. For Texas Utilities that meant not only getting the regulator's approval, but talking with NGOs to identify an approach -- in this case, carbon sequestration and the use of a nonpulverized-coal, lower-emissions technology -- that became the basis for the project's relaunch.

That's step one. Step two is re-engaging: understanding, when carbon comes up (and the next issue you hadn't expected), just what will be required to maintain or rebuild trust and the long-term "social license" to operate.

So, please, let today be a day of solidarity. Hug a banker.

Mr. Johnson is co-founder of the consultancy Sustainable Finance.

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