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Implementing a Rights-Based Approach for Financial Regulation

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Outline

- I. Conceptual issues
- II. An Actual Case: Peru
- III. A Concrete Proposal
- IV. Conclusions



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I. Conceptual issues



Introduction

- ❖ States have **the obligation to design policies and rules** that 'respect, protect and fulfill economic, social and cultural rights'.
- ❖ Two questions (one general, one particular):
 - i. Can policymakers design austerity measures that minimize their effects on vulnerable populations, preventing potential episodes of social unrest?
 - ii. Can financial authorities influence the evaluation of projects to mitigate their externalities on communities and prevent potential episodes of social conflict?
- ❖ This presentation focuses on the latter.



Externalities: The link connecting Rights, Risks and Regulation

- ❖ Finance is all about **risk**. Investing is making a (calculated) bet on the future. Two kinds of risk are involved:
 - *Private risk* relates to possible losses incurred by the lender, which are passed on to borrowers (through the interest rate).
 - *Social risks* refers to possible losses suffered by third parties, when -for example- some projects incite social unrest.
- ❖ Both kind of losses affect people's economic, social and (even) cultural **rights**. Because the second kind are borne by third parties, we call them externalities.
- ❖ Externalities are typically tackled through **regulation**.



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II. An actual case: Peru



Where Human Rights and Economic Imperatives Often Collide: Mining

❖ The perceived conflict:

- Income Needs and Modernity versus ..
..Tradition and Tried-and-True Survival Strategies

❖ Specific Conflict Over:

- Water
- Air pollution (e.g. coal or mineral dust)
- Tailings
- Economic surplus (profits, taxes, voluntary contributions)
- Control
- Status (reinforce: price changes)



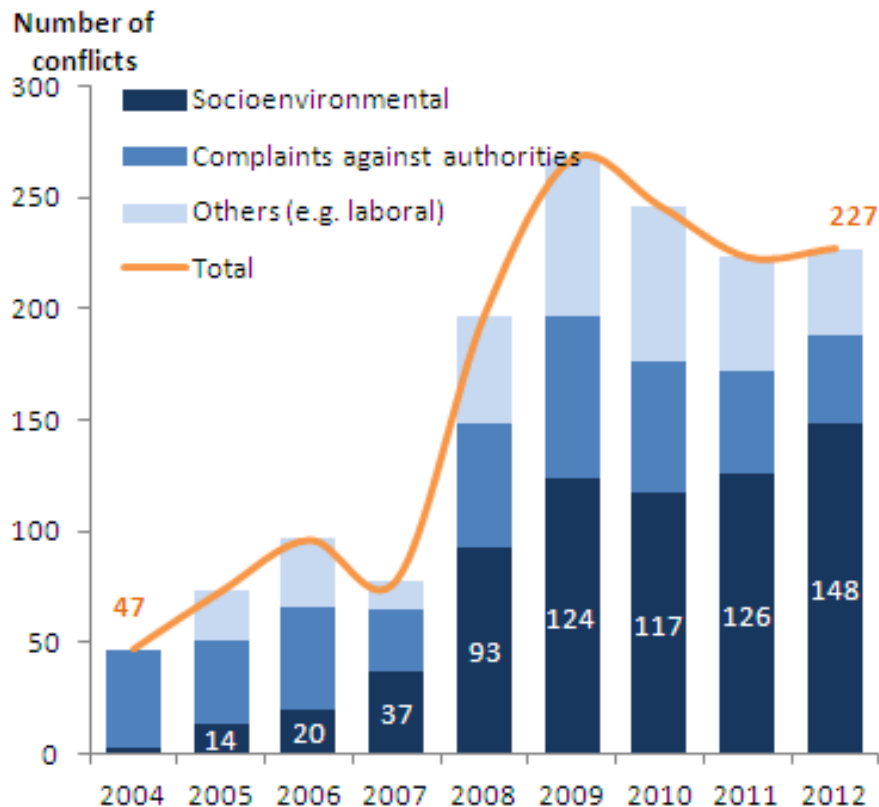
The Epidemiology of Conflict

- ❖ Conflict, like infection, exists, dormant everywhere and all the time.
- ❖ It becomes virulent and dangerous in spots where resistance is weak.
- ❖ Contagion plays hopscotch:
 - No geographical contiguity
 - Similarity of motivations
 - Similarity of correlations of forces



Social Conflicts in Peru

How many and what kind?



Where?





The Side Effects Dominate

- ◆ Externalities are the name of the game:
 - Co-workers and Related Divisions of Companies
 - Suppliers and Clients
 - Communities
 - Local Authorities (Tax & Expenditures)
 - Downstream and Upstream from Communities
 - National Authorities
 - International Spillovers (via price, quantity or finance)



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The chickens come home to roost..

...at the banks:

- Direct funders
- Funders of suppliers and clients
- Funders of third parties
- Funders of government

❖ Social Conflict winds up on some bank's bottom line

- Pro-cyclical monetary policy can aggravate further
- Prudential policy: provisioning can further spread the epidemic



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III. A Concrete Proposal



Voluntary Action

❖ Various precedents:

- The Equator Principles
- IFC Performance Standards
- The OECD Common Approaches
- The UN Guiding Principles on Businesses and Human Rights

❖ These standards have been signed onto by various banks and investors, but they are all voluntary and do NOT provide a level playing field.

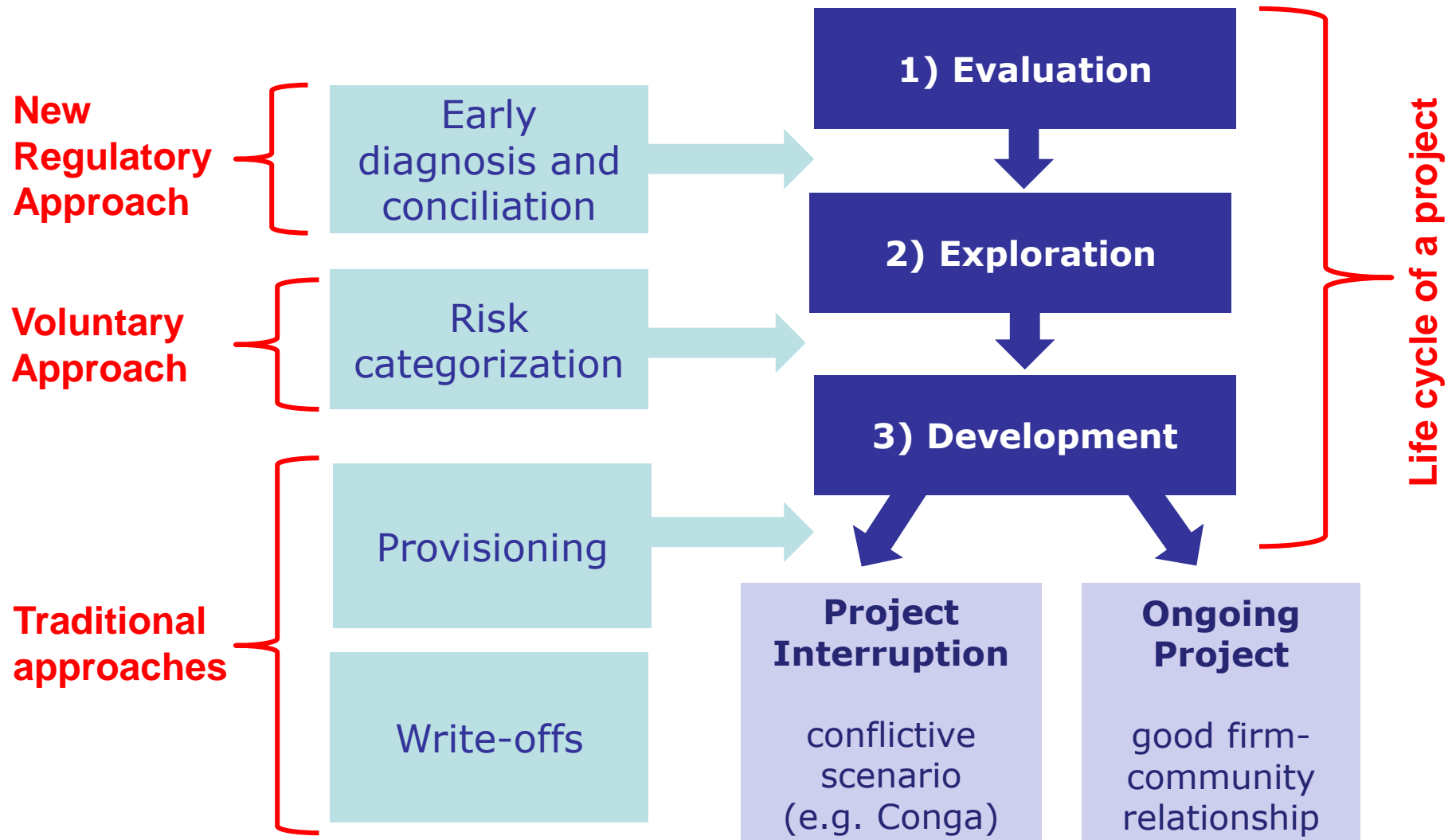


Using clout

- ❖ Companies listen to their bankers.
- ❖ Bankers listen to their Regulators...
 - ...Regulators can affect what companies do in the field.
- ❖ Intervention:
 - We want loss prevention or abatement.
 - Through conflict prevention or abatement.
- ❖ How:
 - Early and thorough diagnosis.
 - Early and sustained conciliation.

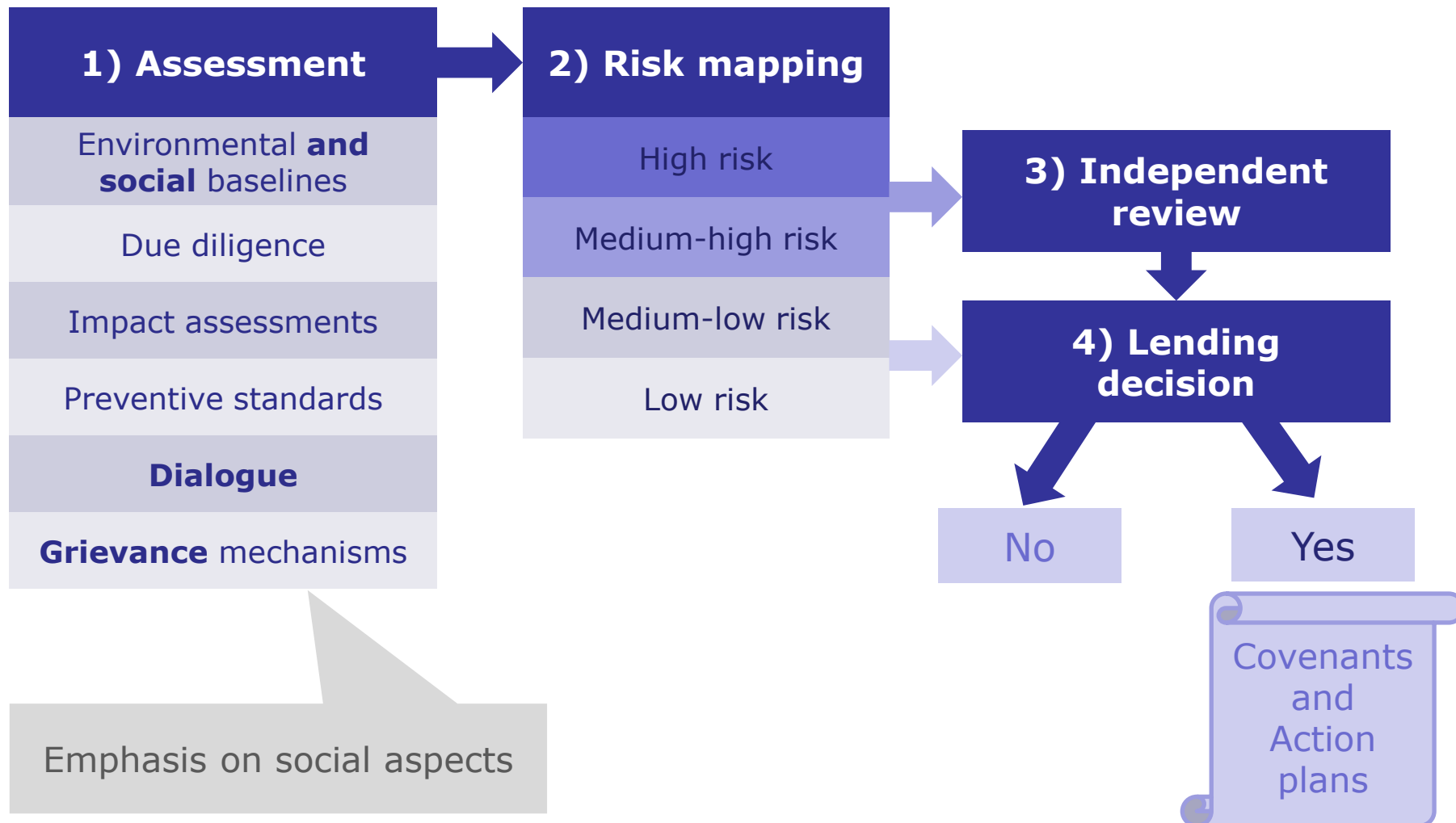


An illustrative example





The Proposed Regs: a 4 legged stool





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IV. Conclusions



Key Messages

- ❖ Rights-based Risk Regulation can be seen as a particular case of Right-based Economic Policies, where the aim is mitigating externalities that adversely affect third parties' rights.
- ❖ Regulations seem an effective remedy because:
 - They level the playing field so lenders are not tempted to compete by offering more lenient standards.
 - They encourage lenders to apply stricter standards and covenants to provide their borrowers with incentives to protect human rights.
- ❖ This is a concrete regulatory proposal whose publication is expected in late October/early November.