Two Keys to Consider: CSR and Human Trafficking as They Relate to Financial Institutions

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Abstract: In the practice of CSR, the prevalence of human trafficking makes avoidance of this activity difficult. The issue of human trafficking is commonly associated with the sex trade but also incorporates forced labor and a variety of other modes. All human trafficking is inextricably tied with money and is thereby tied with financial institutions. United Nations University published a workshop report about the direction financial institutions could take to extricate themselves from ties to human trafficking. This paper examines two of their proposals and the implications of these proposals for CSR, financial institutions, and human trafficking.

In July 2017, United Nations University released its workshop report called *25 Keys to Unlock the Financial Chains of Human Trafficking and Modern Slavery*. The report provides corporations with guidance on combatting human trafficking in its supply chains and/or detecting human trafficking through financial services. Countries should consider human trafficking a money laundering crime in addition to a human rights violation, according to the Ninth Key. The Fourth Key proposes financial institutions take the lead in removing human trafficking from their supply chains. These two Keys have ethical implications for Corporate Social Responsibility (CSR), obligating firms to include into their social responsibility the implementation of the Fourth and Ninth Keys.

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Corporate Social Responsibility (CSR)

CSR is a balance between a corporation's stakeholder responsibilities and its motives for growing. A typical argument favoring the involvement of a corporation in social issues is as follows:

(1) There exist social problems that need to be solved;

(2) An agent who can ameliorate the issues without great cost to itself and/or its people has a moral obligation to do so;

(3) Firms have the ability to ameliorate issues as described in (2);

(4) Therefore, firms have a moral obligation to ameliorate social issues (Moriarty).

The argument connects firms to the power to improve on issues, pinning on them the moral obligation to do so. In step (2), however, the obligation is guaranteed only if a firm can ameliorate social issues without great cost to itself. This great cost may be financial burdens, slow growth, reduced product/service quality, and – most importantly – reduced stakeholder wealth. Given the many different tasks a corporation must complete to stay afloat, it may seem that CSR is a side project of a firm. Because it is not the main focus, a side project is likely to receive varying amounts of attention depending on available resources. Therefore, (2a) should be added to the argument: CSR exists as a perennial, yet quotidian, side project of corporations, which needs to be balanced with the main focus of corporations.

Nevertheless, George and Smith's discussion of the Carlson hospitality company demonstrates a side project can complement the main focus. George and Smith discuss a case study of the global hotel company Carlson Hospitality Worldwide, Inc. The study examines the effects of the company publicizing its actions against human trafficking. Carlson CEOs in the early 2000s signed various human rights compacts and used "a very hands-on approach," including a "Responsible Business training program," to mitigate human trafficking in its supply chain. In 2009, a Carlson hotel manager in Belize reported suspicious activity. Consequently, this manager helped to catch a child trafficker. As a result, Carlson received good publicity (George and Smith, 63). The hands-on approach and training program are significant expenditures of money and effort, and implementing human rights agreements is a significant constraint on the firm's ability to grow. Yet the payoff was good publicity. Increased public awareness that Carlson acted against the problem of human trafficking earned them recognition and support of its stakeholders (George and Smith, 64). A firm's main focus and its side project need not be mutually exclusive, as demonstrated by Carlson. Furthermore, the Carlson case shows the cost mentioned in (2) is a factor that takes into account the costs and benefits of the socially responsible action.

The Ninth Key of the UN University report recommends adding yet another dimension to CSR by combining it with money laundering and ties together two seemingly disparate ethical principles. The key is presented here:

> "Encourage countries to consider human trafficking and modern slavery as money-laundering and terrorist financing risks in their national risk assessments (FATF Special Recommendation 1), and pay attention to these issues in FATF, FATF-Style Regional Body and Egmont Group analysis and discussions." (University, 23)

The Key does not suggest countries change the way their governments consider human trafficking, but rather expand the category of money laundering to include human trafficking. This category change makes human trafficking an economics issue and not just a human rights issue. With a human rights issue, one can directly appeal to social science and/or the Universal Declaration of Human Rights. With money laundering, one appeals to numbers and data and bases ethical reasoning on empirical analysis as well. Yet, these two approaches can be tied together.

Corporate Economic Responsibility

The ethical principles that apply to money laundering also include an element of corporations being socially responsible, making the responsibility requisite to the existence of the corporation. Money laundering is "the term given to the… criminalised act of disguising proceeds of illegal activity as being derived from a legal source" (Spedding, 72). Rather than talking about human trafficking specifically, this Key tackles the result of human trafficking – the money used for trafficking – not the people themselves.

Paul Tillich talks about money laundering through the principles behind the "courage to be" which he defines as "the courage of self-affirmation" and "the courage to be as part of a community." He says financial fraud like money laundering goes directly against the courage to be or exist (Dion). Because money laundering disrupts this ability "to be as a part of a community," it endangers a corporation's interactions with consumers, shareholders, and the world at large. It is something that must be a main focus for a corporation because money laundering impacts both stakeholders and profit, which are the basis for a corporation's existence. Through the two-pronged approach to human trafficking using human intel (e.g. the Carlson hotel manager) and tracing money flows, the Ninth Key makes the fight against human trafficking more integral to the work of a financial institution.

A case study from the Financial Action Task Force (FATF) elucidates the links between human trafficking and money laundering more concretely, treating human trafficking as a business rather than as a crime. The investigation focuses on a criminal group that trafficked women in Spain. This group owned several "night clubs" where women were exploited. Money obtained through trafficking was sent via remittances to other countries. Investigators found out that this group tended to use physical cash, making remittances in small amounts over many transactions. After tracking cross-border transfers that seemed to fit the spending pattern discovered, investigators learned that many of these transfers were to the same person (FATF, 31-32). The case study shows money laundering and human trafficking can be tracked via characteristic spending patterns. At the same time, though, the method in this tracking is distinct from instances like the Carlson case, which used employee training and CSR investment. In the FATF case, the method seems purely economic in process. The tracking suggests the corporation is just doing its job of assuring consumer safety rather than going above and beyond to try and fight a social issue. With the recommendation in the Ninth Key, the ethics associated with firms' fight against human trafficking, rather than mandating a side project, attach the side project to the main focus and make a stronger incentive for financial institutions to combat human trafficking.

But Should the Responsibility Be Left to Corporations?

Another element to introduce is whether corporations themselves can be relied on to detect and report human trafficking even with such strong moral obligations to do so. If governments, communities, and other entities cannot be relied on to mitigate human trafficking, the job falls to the corporations. Galit A. Sarfaty conducted an empirical study that helps test the variability in compliance of various firms to standards presented in section 1502 of the Dodd-Frank Act. Section 1502 of the Act requires companies that purchase conflict minerals like tantalum and tungsten from the DRC to complete a form with the Securities and Exchange Commission (SEC) if they have reason to believe the minerals purchased were not obtained through ethical means (111th Congress, 838). In the same year the Dodd-Frank Act was passed, the Organization for Economic Cooperation and Development (OECD) released a set of standards for Due

Diligence, a process by which a firm can better ensure ethical sourcing of their minerals from the DRC (OECD, 7-9). Sarfaty analyzed the percentage of the corporations that complied with the OECD standards by looking at the SEC reports mandated by section 1502 of Dodd-Frank. The study revealed smaller, less profitable firms are less likely to comply with OECD standards.

Sarfaty's analysis took into account various levels of each company's compliance with Due Diligence procedures and compared them using two tabulated methods and a linear regression analysis. She looked at Conflict Minerals Reports (CMRs) submitted to the SEC by 967 mining companies and looked at whether or not companies complied with the following OECD standards:

(1) Long-term record keeping by the company on its supply chain;

(2) Incorporation by the company of its Due Diligence policy into contracts with suppliers of minerals from mines;

(3) Surveying by the company of all suppliers of conflict minerals and follow up on any non-responsive/incomplete surveys;

(4) The relationship between the company and its supplier in as far as working together to mitigate risk in the supply chain;

(5) Encouragement by the company of suppliers to be certified by a third party as not engaging in forced labor practices.

Sarfaty then created a variable called *OECDComply* that generates a value from 0 to 5 indicating the number of standards with which a company complies. She tabulated her results as shown in Tables 1 and 2 (Sarfaty, 441-445). She then completed a linear regression analysis to look at relations between *OECDComply* and other variables like company assets, liquidity, and profitability – shown in Table 3 (Sarfaty, 446).

TABLE 1: FREQUENCY TABLE OF *OECDCOMPLY*

Total Score Given to CMR: *OECDComply*	Frequency	Percentage
0	159	16.44
1	305	31.54
2	267	27.61
3	165	17.06
4	63	6.51
5	8	0.83

TABLE 2: DUE DILIGENCE RATE FOR COMPANIES FILING CMRS

Due Diligence Level	*OECDComply*	Frequency	Percentage
Weak Due Diligence	0-1	464	47.98
Moderate Due Diligence	2-3	432	44.67
Strong Due Diligence	4-5	71	7.34

TABLE 3: REGRESSION RESULTS OF TOTAL SCORE (*OECDCOMPLY*)

Ad_Sales	4.13**
	(1.77)
Log_Assets	.057***
	(.021)
ROA	.055***
	(.019)
Liquidity	-.395
	(.265)
CFSI	.302***
	(.079)
OtherRef_1	.343**
	(.146)
OtherRef_2plus	.418**
	(.193)
CalTSCA	.201*
	(.112)
Constant	.481
	(.370)
Number of Observations	967
R-squared	.084

The dependent variable in this OLS Regression is *OECDComply*. Two-digit SIC industry controls are included (but not shown). Robust standard errors in parentheses.
* Significant at the 10% level
** Significant at the 5% level
*** Significant at the 1% level

Her linear regression shows a significant relationship between: *OECDComply* and sales, as well as *OECDComply* and firm size. In other words, smaller, less profitable firms are less likely to comply with OECD standards.

The Fourth Key recommends increased action by financial institutions like the firms discussed thus far to comply with standards of reporting that are much like those of Due Diligence. Drawing from Sarfaty, this key needs to take into account the variability in compliance from firm to firm.

> "Encourage financial institutions' leadership to prioritize internal action against human trafficking and modern slavery, for example by: (a) designating a senior official as a modern slavery/human trafficking 'focalpoint' to coordinate the organization's response across compliance, investment, procurement, human resources, public relations and other functions; (b) seeking periodic reporting to organizational leadership on risk exposure and response; (c) inclusion of relevant information in annual reports" (University, 22-23)

Given the results with *OECDComply*, one expects significantly less than the number of firms financially tied to human trafficking to follow through on this recommendation. The Carlson case worked out primarily due to the strong connection between the main focus and side project of the hospitality company. The Fourth Key does not recognize the variability in smaller firms that enable trafficking transactions to take place there. Such small firms may not have an established identity they can tie into some compatible CSR work. Indeed, they may not even have the funds to do so. The FATF case study demonstrates that money laundering tied to human trafficking occurs in small transactions, which are more likely to be made by or within smaller firms – the very firms from Sarfaty's study that are not expected to comply well with OECD Due Diligence standards. The Fourth Key seems to be more of an ideal scenario than a recommendation, in light of Sarfaty's analysis.

Financial institutions in the financial chains of human trafficking are, because of their variability in size and goals, tied in with human trafficking. While George and Smith attest to the social aspect of human trafficking with the Carlson case, the FATF study shows that human trafficking is as much a financial issue as it is a social one. These economic ties illuminate the connections between the seemingly separate ethics of CSR and money laundering, adding more financial weight to Corporate Social Responsibility. Even with the attempt of the Dodd-Frank Act to stop firms from engaging, knowingly or unknowingly, from human trafficking, it can be seen through Sarfaty's analysis there is uneven compliance by firms, based on firm size and revenues. This non-compliance results in the ongoing existence of a place for human trafficking to occur and perhaps the most socially responsible thing all companies can do is recognize the presence of the problem in their supply chains.

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