The OECD Due Diligence for Responsible Corporate Lending and Securities Underwriting

An analysis and briefing for civil society organisations on the strongest elements for use in advocacy

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BANKTRACK

Introduction

On October 28th, 2019, the OECD launched new guidance on Due Diligence for Responsible Corporate Lending and Securities Underwriting (hereinafter "the guidance"). The guidance is based and elaborates on the OECD Guidelines for Multinational Enterprises, providing authoritative clarifications of banks' responsibilities to prevent adverse impacts on human rights and the environment. This is the OECD's second guidance paper on responsible business conduct in the financial sector, following the 2017 guidance on Responsible Business Conduct for Institutional Investors.

This new guidance represents important progress and a step forward in the international normative framework that serves to encourage responsible conduct by banks and other financial sector actors and that also serves to hold financial actors accountable for adverse social and environmental impacts associated with their activities. It provides authoritative clarifications of government-backed expectations of banks, making particularly important clarifications on issues related to when a bank has "contributed" to an adverse impact through its lending or underwriting and what role a bank can and should play in remediating adverse impacts associated with its activities.

The 48 governments adhering to the OECD Guidelines for Multinational Enterprises have made a commitment to promote this guidance with banks and monitor its implementation, and banks operating or headquartered in these 48 countries are expected to follow the guidance. Civil society, including trade unions, non-governmental organisations (NGOs), and individuals, who feel that a bank has not abided by the recommended responsible behaviour can file a complaint against the bank at the National Contact Point (NCP) in the country in which the bank is headquartered and request that the NCP refer to the guidance in providing recommendations to the bank.

Some key areas in which the new paper provides important clarifications and guidance related to the due diligence and responsible conduct expected of banks include:

1. Relationship of banks to adverse impacts and remedy
2. Bank-level grievance mechanisms
3. Transparency and client confidentiality
4. Sustainability responsibilities
5. Public policy advocacy
6. Engagement with rightsholders
7. Disengagement and divestment

This briefing provides further elaboration on each of these areas below.

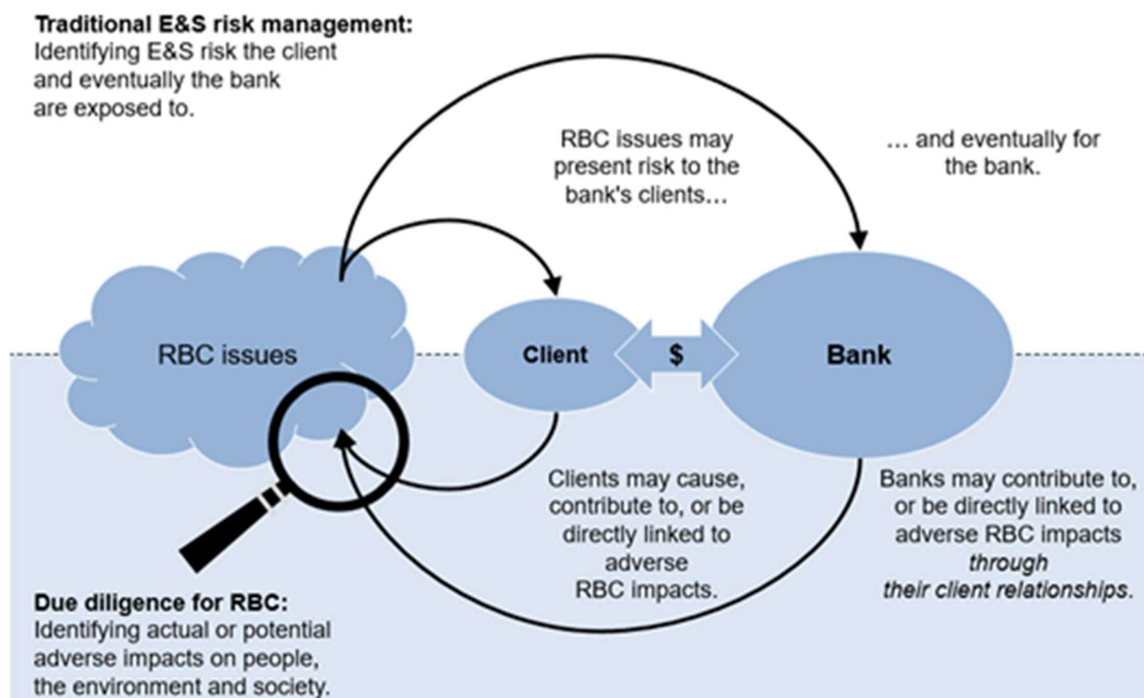
Key areas of authoritative clarification provided by the guidance

1. Relationship of banks to adverse impacts and remedy

The new guidance provides important new clarifications regarding the **relationship of banks to adverse social and environmental impacts** caused by clients to whom they provide loans or underwriting services. The guidance clearly recognizes **that banks providing loans and underwriting services can contribute to adverse human rights and environmental impacts** through both actions and omissions.

> *"Adverse impacts caused by a client of the bank would, in the majority of cases, be "directly linked" to the financing or underwriting services of the bank, which has a business relationship with the client. In some instances, however, a bank may also contribute to adverse impacts if the activities of the bank somehow cause, facilitate or incentivise the client to cause harm. … Where a bank is contributing to an adverse impact, it is expected to provide for or cooperate in its remediation."* ("How can a bank assess its involvement with an adverse impact?", p. 42)

The Guidance depicts the difference between the way the "Due diligence for RBC" approach contemplates the relationship of banks to adverse impacts with that of "traditional environmental and social risk management" in this way[1]:



[1] Figure can be found on p.15 of the guidance https://mneguidelines.oecd.org/Due-Diligence-for-Responsible-Corporate-Lending-and-Securities-Underwriting.pdf

This has important implications for the role of banks in remediating adverse impacts that have occurred, because when a bank is determined to have contributed to an impact, it is responsible for contributing to remediation. This represents significant progress in normative expectations, and authoritatively clarifies a point that had been hotly debated between stakeholders in recent years.

Importantly, a bank's own lack of or failure to conduct effective due diligence to prevent clients from causing impacts is cited as factor in determining whether a bank contributed to the impact. Continuing to provide additional finance "where an adverse impact caused by the client continues or reoccurs" is also cited as relevant in establishing contribution.

Where the bank is *directly linked* to an adverse impact through a client, but does not *cause* or *contribute* to it, the guidance clarifies that while the bank is not responsible for remedying the impact, "it still has a responsibility to seek to prevent or mitigate the impact, using its leverage, which may involve efforts to influence the client to provide remediation"(p. 19).[2]

2. Bank-level grievance mechanisms

The new OECD guidance clarifies in several places how and why banks should establish and/or participate in grievance mechanisms. This is significant as banks have been slow to make progress towards this, although it is a clear requirement of the UN Guiding Principles on Business and Human Rights. To date there is no evidence of private sector banks having, or claiming to have, an effective grievance mechanism in place that extends to the impacts of their finance, although there is progress in this direction.[3]

On the question "do banks need to establish grievance mechanisms?" (p. 61) the paper is unequivocal, stating "banks are expected to have mechanisms in place (their own or one(s) they participate in) to respond effectively if or when grievances arise." In addition, "establishing bank-level grievance mechanisms and/or participating in grievance mechanism established by clients, industry initiatives or others" is cited as a suggested 'practical action' for remediating impacts where appropriate. Bank grievance mechanisms are also cited as helpful for tracking the implementation and effectiveness of due diligence.

3. Transparency and client confidentiality

The new guidance provides a useful explainer of the extent of, and limits of, a bank's duties around client confidentiality ("Box 1. A Bank's Duty of Client Confidentiality", p21), and clearly recognizes that banks can "take steps to promote greater transparency with respect to client relationships without being in breach of this duty" (p20). It recommends that banks can respond to client confidentiality restrictions by obtaining the consent from clients to disclose specific information such as the existence of the client relationship, and advises that such to make disclosures should "ideally"

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[2] This is a point that is made even more strongly in a paper on "Enabling Remediation" produced by the multi-stakeholder Dutch Banking Agreement. See https://www.imvoconvenanten.nl/en/banking/news/paper-enabling-remediation.

[3] E.g. see BankTrack Human Rights Benchmark 2019 at www.banktrack.org/hrbenchmark

be secured at the outset of a relationship. This reinforces recent calls from civil society for banks to standardise disclosure of lending and underwriting to high-risk business sectors.[4]

The guidance notes that "broadly used template covenant agreements, such as that of the Loan Markets Association, do not include such (transparency) provisions" but that "modifying such template agreements to include client consent to disclose the existence of the client relationship would be very useful to standardising this practice." This could support efforts to engage with banks or the Loan Markets Association directly to change template agreements in support of greater disclosure.

4. Sustainability responsibilities

Of particular relevance to green finance, the new guidance makes clear references to the Paris Climate Agreement and SDGs, including the statement, "Financial institutions can contribute to sustainability goals *first and foremost* by seeking to avoid and address environmental and social risks associated with their activities." (emphasis added). This is significant given that banks still tend to place more emphasis on their support for 'green' projects than on avoiding negative impacts.

The OECD and adhering governments should now promote this guidance with banks and investors, and in particular ensure that their NCPs use the guidance in making recommendations to banks on how to carry out due diligence.

5. Public policy advocacy

The guidance recognises that banks may engage in public policy advocacy to seek to raise minimum standards as part of their approach to using leverage. For example, the guidance states,

> *"The approaches banks can employ to use their leverage to influence clients are broad in scope. They are not limited to direct engagement with clients but can also involve, as appropriate and subject to resources, involvement in industry initiatives targeting certain RBC issues, collective action on specific geographic or company-specific issues, directing capital towards responsible companies over time, etc. Banks may also engage in advocacy in the context of public policy or industry initiatives which seek to raise minimum standards of conduct expected of clients or banks' due diligence processes".* (p. 23)

This should encourage banks to expand their approach beyond client engagement to encompass using their voice to encourage standard-setting at a national or international level. Examples of this have included banks engaging with national governments for strong climate laws; banks working with regulators in the context of national initiatives for sustainable finance; or banks engaging with national standard-setting bodies to raise minimum standards in specific high-risk business sectors

[4] See, for example, https://www.banktrack.org/article/world_s_biggest_banks_routinely_hide_links_to_human_rights_and_environmental_abuses_behind_client_confidentiality_study

such as cocoa or palm oil.[5]

6. Engagement with rightsholders

The guidance recognises the importance of ensuring the views of impacted rightsholders or their legitimate representatives are considered by banks during due diligence, particularly when identifying appropriate forms of remedy and devising prevention and mitigation strategies regarding specific impacts.

It suggests that, for high-risk clients and activities, banks should play an active role in examining their clients' engagement with rightsholders, and identify actions the client can take to address shortcomings where their engagement is deemed unsatisfactory (p. 25).

Further, the guidance notes:

> *"Banks may face constraints in engaging directly with rightsholders impacted by the behaviour of their clients due to concerns about client confidentiality, logistical constraints as well as other perceived legal risks associated with their interference in management activities. However, situations have arisen where banks have engaged directly with rightsholders impacted by the behaviour of client companies to better understand how clients can seek to prevent or mitigate risks or remediate adverse impacts."* (p. 25)

This helps make clear that direct engagement by banks with rightsholders is possible, while it may not be standard practice.

7. Disengagement and divestment

The guidance strikes a thoughtful balance on the question of when it is right to disengage or divest from a client in response to adverse impacts. Although it is clear that in general, "Under the MNE Guidelines, disengagement will often be a last resort" it is also clear that there is a role for exclusion policies, blacklists and divestment "for highly damaging industries or products or (…) for companies with a history of irresponsible behaviour" (p. 52-53).

The guidance also makes clear that banks should also consider the impact of terminating a relationship, with "the priority being to avoid creating greater harm." It also emphasizes that "cutting and running" from a client is unlikely to remedy the impact on its own, noting: "In cases where the impact is severe and/or the bank has contributed to it, further steps may be needed to mitigate or remedy the impact for example through encouraging the client to provide remedy to impacted stakeholders or rightsholders."

[5] See for example the Indonesian Sustainable Finance Initiative and the multi-stakeholder approach towards sustainable cocoa proposed by the Dutch Banking Sector Agreement