



# Due Diligence for Responsible Corporate Lending and Securities Underwriting

Key considerations for banks implementing the OECD Guidelines for Multinational Enterprises



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## *Foreword*

Financial institutions have a key role to play in driving global sustainability through directing financing towards measures to achieve the Sustainable Development Goals and the Paris Climate Agreement and through seeking to avoid and address environmental and social risks associated with their activities.

This paper helps banks and other financial institutions implement the due diligence recommendations of the OECD Guidelines for Multinational Enterprises in the context of their corporate lending and underwriting activities. Currently no widely recognized standard on responsible business conduct (RBC) exists for these type of transactions, although they represent a significant portion of client services of commercial banks.

Due diligence can help banks prevent or address adverse impacts related to human and labour rights, the environment, and corruption associated with their clients as well as avoid financial and reputational risks. This paper identifies key actions under each step of the due diligence process and includes discussion of key considerations, such as challenges, existing practices, or regulations specific to the corporate lending and securities underwriting transactions which may impact due diligence approaches.

This paper has been developed with a multi-stakeholder advisory group of over 50 representatives from leading banks and other financial institutions, government, civil society, international organisations and other experts. It has also benefited from input provided by banking practitioners during expert working sessions organised in March 2018 in New York City and in September 2018 in London. The OECD Working Party on Responsible Business Conduct approved the paper on 6 September 2019 and the OECD Investment Committee approved the paper on 7 October 2019.

This paper is part of the work the OECD undertakes to clarify expectations of responsible business conduct in the context of enterprises operating in the financial sector. The OECD has also developed tailored guidance to help enterprises carry out due diligence in other sectors, specifically: extractives, and particularly minerals from conflict affected and high-risk areas; garment and footwear; and agriculture.



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## Introduction

Financial institutions will play a key role in contributing to sustainable development through promoting responsible business conduct amongst their clients and financing projects that can have positive sustainability impacts. In 2015, the Paris Agreement and the Sustainable Development Goals (SDGs) were adopted. Scaling up financial flows will be critical to achieving the measures outlined under these agendas. For example, around USD 6.9 trillion of investment in infrastructure is required annually between 2016 and 2030 in order to meet global development and climate needs.<sup>1</sup> Governments are increasingly inclined to exploit the scale of assets and leverage of financial institutions to support these objectives. G20 leaders have highlighted the need to align financial flows (from both public and private institutions) to promote climate goals and achieve the objectives of the SDGs.<sup>2</sup>

To contribute to sustainability goals it is also important that financial institutions avoid and address environmental and social risks associated with their activities. In this respect, one of the most powerful contributions business can make to sustainable development is to embed responsible business conduct in their activities and across their value chains through strong due diligence processes. By carrying out due diligence, banks can ensure that financing flows to projects and companies that behave responsibly and ultimately benefit people and the planet.

### Purpose and Target Audience

This paper provides guidance for banks and other financial institutions (hereinafter “banks”) to implement the recommendations of the [OECD Guidelines for Multinational Enterprises](#) (“MNE Guidelines”) in the context of their corporate lending and securities underwriting activities. Specifically, this paper explains what due diligence for responsible business conduct entails, and provides practical considerations for banks at each step of the due diligence process. This paper may also be helpful to other stakeholders seeking to understand due diligence approaches of banks. The MNE Guidelines have a unique promotion and grievance mechanism – the National Contact Points (NCPs).<sup>3</sup> The paper can also be a useful resource for NCPs in understanding and promoting the MNE Guidelines.

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<sup>1</sup> Mariana Mirabile, Virginie Marchal and Richard Baron, OECD (2017) Technical note on estimates of infrastructure investment needs Background document to the report Investing in Climate, Investing in Growth. <https://www.oecd.org/env/cc/g20-climate/Technical-note-estimates-of-infrastructure-investment-needs.pdf>

<sup>2</sup> G20 (2017), *G20 Hamburg Climate and Energy Action Plan for Growth*, [http://unepinquiry.org/wp-content/uploads/2017/07/Climate\\_and\\_Energy\\_Action\\_Plan\\_for\\_Growth.pdf](http://unepinquiry.org/wp-content/uploads/2017/07/Climate_and_Energy_Action_Plan_for_Growth.pdf)

<sup>3</sup> In accordance with the Decision of the Council on the OECD Guidelines for Multinational Enterprises, as amended in 2011, National Contact Points are set up to further the effectiveness of the Guidelines by undertaking promotional activities, handling enquiries and contributing to the resolution of issues that arise relating to the implementation of the Guidelines in specific instances. This paper may be used by National Contact Points to promote the MNE Guidelines but is not

The MNE Guidelines are non-binding recommendations addressed to multinational enterprises by governments on responsible business conduct (“RBC”). They acknowledge and encourage the positive contributions that business can make to economic, environmental and social progress, but also recognise that business activities can result in adverse impacts related to workers, human rights, the environment, corruption, consumers and corporate governance. The MNE Guidelines therefore recommend that businesses carry out risk-based due diligence to avoid and address such adverse impacts associated with their operations, their supply chains and other business relationships.

This paper is part of the work the OECD undertakes to clarify expectations of responsible business conduct in the context of enterprises operating in the financial sector. This paper represents one outcome of this project. In 2017, the OECD also published a paper on Responsible Business Conduct for Institutional Investors<sup>4</sup>.

## Scope

This paper provides guidance on due diligence approaches for banks in the context of corporate lending and securities underwriting activities, the process of raising capital for clients, for companies,<sup>5</sup> for both public and private placements (See Annex B). It does not consider due diligence approaches for banks in the context of project-based or asset-based finance (e.g. loans for corporate real estate) or other asset-based transactions. It likewise does not consider due diligence approaches for derivative financial products (e.g. securitized debt or credit derivatives) or outline specific approaches for entities that support the banking sector (e.g. market research providers, credit risk agencies). However, the recommendations in this paper may be a useful reference for these entities since the recommendations of the MNE Guidelines are also applicable to them.

While banks may cause or contribute to adverse impacts in their own operations just like any other enterprise (e.g. adverse labour impacts with respect to their own employees), this paper focuses on carrying out due diligence with respect to adverse impacts associated with a bank’s client’s activities. Banks’ approaches to managing environmental and social risks have traditionally focused on project finance transactions or involved screening of limited, pre-defined, high-risk sectors. As such, banks have an opportunity to enhance and broaden due diligence processes across their portfolios to better understand and respond to risks associated with their corporate lending and underwriting activities. The standards and due diligence approach recommended under the MNE Guidelines apply to all transactions. They are not limited to specific types of transactions or those surpassing specific monetary thresholds, but follow a risk-based approach (See *Characteristic of Due Diligence*).

The MNE Guidelines include a range of substantive chapters subject to due diligence expectations. Topics covered by the due diligence expectations under the MNE Guidelines

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intended to serve as a basis for the submission of specific instances. See also OECD Guidelines, Commentary on the Implementation Procedures of the OECD Guidelines for Multinational Enterprises, paragraph 25. See also Box 2.7.

<sup>4</sup> (OECD, 2017) Responsible Business Conduct for Institutional Investors, <https://mneguidelines.oecd.org/RBC-for-Institutional-Investors.pdf>

<sup>5</sup> This paper does not consider lending transaction with sovereign clients, which may entail additional due diligence considerations.



are: human rights; employment and industrial relations; environment; combating bribery, bribe solicitation and extortion; consumer interests and disclosure.

This paper focuses primarily on risks associated with the human rights, employment and environment chapters of the MNE Guidelines. Corruption issues are often subject to rigorous national laws and are closely monitored by legal and/or compliance departments of banks. As such, although due diligence expectations extend to impacts under the chapter on Combating Bribery, Bribe Solicitation and Extortion of the MNE Guidelines, the recommendations and key considerations of this paper do not focus on these risks on the assumption that they are already well defined under international and national laws and guidance.

Similarly, while a number of banking activities will have impacts on consumers in the context of the retail market, consumer interest issues are not the focus of this paper. However, banks should seek to draw from the entire range of processes and systems relevant for their own due diligence instead of using silo approaches. This paper therefore highlights opportunities for collaboration among different departments within banks where most relevant.

## CHAPTERS OF THE OECD GUIDELINES

### I. Concepts and Principles



The first chapter of the Guidelines sets out concepts and principles that put into context all of the recommendations in the subsequent chapters. These concepts and principles (e.g. obeying domestic law is the first obligation of enterprises) are the backbone of the Guidelines and underline the fundamental ideas behind the Guidelines.

### II. General Policies



This chapter is the first to contain specific recommendations to enterprises in the form of general policies that set the tone and establish a framework of common principles for the subsequent chapters. It includes important provisions such as implementing due diligence, addressing adverse impacts, engaging stakeholders, and others.

### III. Disclosure



Clear and complete information on the enterprise is important to a variety of users. This chapter calls on enterprises to be transparent in their operations and responsive to increasingly sophisticated public demands for information.

### IV. Human Rights



Enterprises can have an impact on virtually the entire spectrum of internationally recognised human rights. As such, it is important that they meet their responsibilities. This new chapter of the Guidelines draws on and is aligned with the UN "Protect, Respect and Remedy" Framework and the Guiding Principles on Business and Human Rights that operationalise that framework.

### V. Employment and Industrial Relations



The ILO is the competent body to set and deal with international labour standards and to promote fundamental rights at work as recognised in the ILO 1998 Declaration on Fundamental Principles and Rights at Work. This chapter focuses on the role the Guidelines have in promoting observance among MNEs of the international labour standards developed by the ILO.

### VI. Environment



The environment chapter provides a set of recommendations for MNEs to raise their environmental performance and help maximise their contribution to environmental protection through improved internal management and better planning. It broadly reflects the principles and objectives of the Rio Declaration on Environment and Development and Agenda 21.



**Note:** This page is a copy/paste of previously agreed text used to describe each chapter of the MNE Guidelines from OECD Due Diligence Guidance for Responsible Business Conduct (2018).

# FOR MULTINATIONAL ENTERPRISES

## VII. Combating Bribery, Bribe Solicitations and Extortion



Bribery and corruption are damaging to democratic institutions and the governance of corporations. Enterprises have an important role to play in combating these practices. The OECD is leading global efforts to level the playing field for international businesses by fighting to eliminate bribery. The recommendations in the Guidelines are based on the extensive work the OECD has already done in this field.

## VIII. Consumer Interests



The Guidelines call on enterprises to apply fair business, marketing, and advertising practices and to ensure the quality and reliability of the products that they provide. This chapter draws on the work of the OECD Committee on Consumer Policy and the Committee on Financial Markets, and of other international organisations, including the International Chamber of Commerce, the International Organisation for Standardization and the UN.

## IX. Science and Technology



This chapter recognises that MNEs are the main conduit of technology transfer across borders. It aims to promote technology transfer to host countries and contribution to their innovative capacities.

## X. Competition



This chapter focuses on the importance of MNEs carrying out their activities in a manner consistent with all applicable competition laws and regulations, taking into account the competition laws of all jurisdictions in which their activities may have anti-competitive effects. Enterprises need to refrain from anti-competitive agreements, which undermine the efficient operation of both domestic and international markets.

## XI. Taxation



The Guidelines are the first international corporate responsibility instrument to cover taxation, contributing to and drawing upon a significant body of work on taxation, most notably the OECD Model Tax Convention and the UN Model Double Taxation Convention between Developed and Developing Countries. This important chapter covers fundamental taxation recommendations.



## Structure

The introduction provides context on the basis, purpose, target audience and scope of this paper.

Section 1 provides a high-level overview of the normative basis for due diligence under the MNE Guidelines and its broad implications for banks. In 2018, the OECD published Due Diligence Guidance for Responsible Business Conduct, which sets out a common framework for due diligence processes across all sectors.<sup>6</sup> Throughout this paper due diligence approaches and characteristics as articulated in the OECD Due Diligence Guidance are included in grey text boxes followed by more detailed recommendations tailored to corporate lending and securities underwriting transactions.

Section 2, the main body of this paper, describes the core elements under each component of the due diligence process. These are organised into distinct steps; though in practice the process of due diligence is ongoing, iterative and not necessarily sequential, as several steps may be carried out simultaneously with results feeding into each other. This section includes an overview of practical actions that illustrate how to implement or adapt as needed supporting measures with respect to the due diligence process in the context of corporate lending and securities underwriting. Not every practical action will be appropriate for every situation. Likewise, enterprises may find additional actions or implementation measures useful in some situations. This section also includes a discussion of key considerations and approaches to potential challenges banks may face when carrying out due diligence.

Finally, the paper includes several annexes to provide additional background on: 1) terminology used in the MNE Guidelines such as “due diligence” which may be associated with different meanings 2) descriptions and diagrams to illustrate corporate lending and securities underwriting transactions.

The annexes illustrating corporate lending and securities underwriting transactions are intended to provide explanatory information for stakeholders such as NCPs, policy-makers, multinational enterprises, workers, trade unions and civil society who are not banking practitioners but may be interacting with issues of RBC in the context of corporate lending and securities underwriting.

## Links to related processes and instruments

**Other OECD instruments:** The MNE Guidelines are referenced in a range of other OECD instruments that reinforce the interlinkages between RBC and other areas, including: the G20/OECD Principles of Corporate Governance; the Guidelines on Corporate Governance of State-Owned Enterprises; the Common Approaches for Officially Supported Export Credits and Environmental and Social Due Diligence; the Policy Framework for Investment; the Recommendation of the Council on Public Procurement; and the Recommendation of the Council for Further Combating Bribery of Foreign Public Officials in International Business Transactions.

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<sup>6</sup> The OECD Due Diligence Guidance for Responsible Business Conduct was developed through a multi-stakeholder process and approved by the 48 adherent governments to the MNE Guidelines. See OECD (2018) Due Diligence Guidance for Responsible Business Conduct <https://mneguidelines.oecd.org/OECD-Due-Diligence-Guidance-for-Responsible-Business-Conduct.pdf>

**Other multilateral processes and instruments:** In relation to human rights issues, including the human rights of workers, the recommendations in this paper seek to align with the UN Guiding Principles on Business and Human Rights (UNGPs), the ILO Declaration on Fundamental Principles and Rights at Work, ILO conventions and recommendations referenced within the MNE Guidelines, and the ILO Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy.<sup>7</sup>

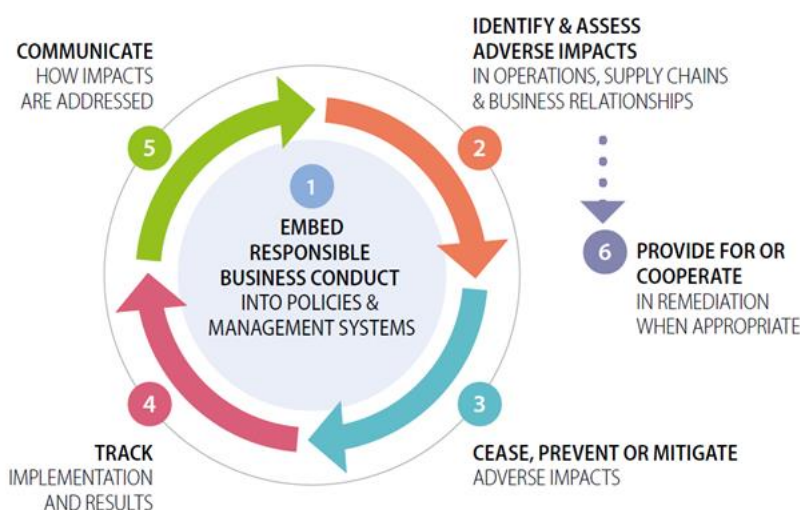
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<sup>7</sup> UN (2011), UN Guiding Principles on Business and Human Rights, <https://business-humanrights.org/en/un-guiding-principles>; ILO (1998), ILO Declaration on Fundamental Principles and Rights at Work, [www.ilo.org/declaration/lang--en/index.htm](http://www.ilo.org/declaration/lang--en/index.htm); ILO (2017), ILO Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy, 5<sup>th</sup> Edition, <http://www.ilo.org/empent/areas/mne-declaration/lang--en/index.htm>

## Chapter 1. Overview of due diligence for responsible business conduct & implications for banks

Due diligence is the process enterprises should carry out to identify, prevent, mitigate and account for how they address actual and potential adverse impacts in their own operations, their supply chain and other business relationships, as recommended in the MNE Guidelines. Effective due diligence should be supported by efforts to embed RBC into policies and management systems, and aims to enable enterprises to remediate adverse impacts that they cause or to which they contribute.<sup>8</sup> (See Figure 1.1)

**Figure 1.1. Due diligence process & supporting measures**



Due diligence under the MNE Guidelines is an ongoing process and focuses on the management of actual or potential adverse impacts on the environment and/or the labour and human rights of affected parties, with the objective of preventing and mitigating the risk of these impacts occurring (see Section below on *Adverse impacts and risk*). This conception of due diligence for RBC is different from how due diligence is commonly perceived in the context of banking. In the context of banking, due diligence is generally thought of as a process conducted prior to providing financing or services to a client with the aim of identifying and assessing reputational, legal and financial risks to the bank, rather than with the aim of preventing or mitigating impacts of a client's operations on the environment, workers and communities.

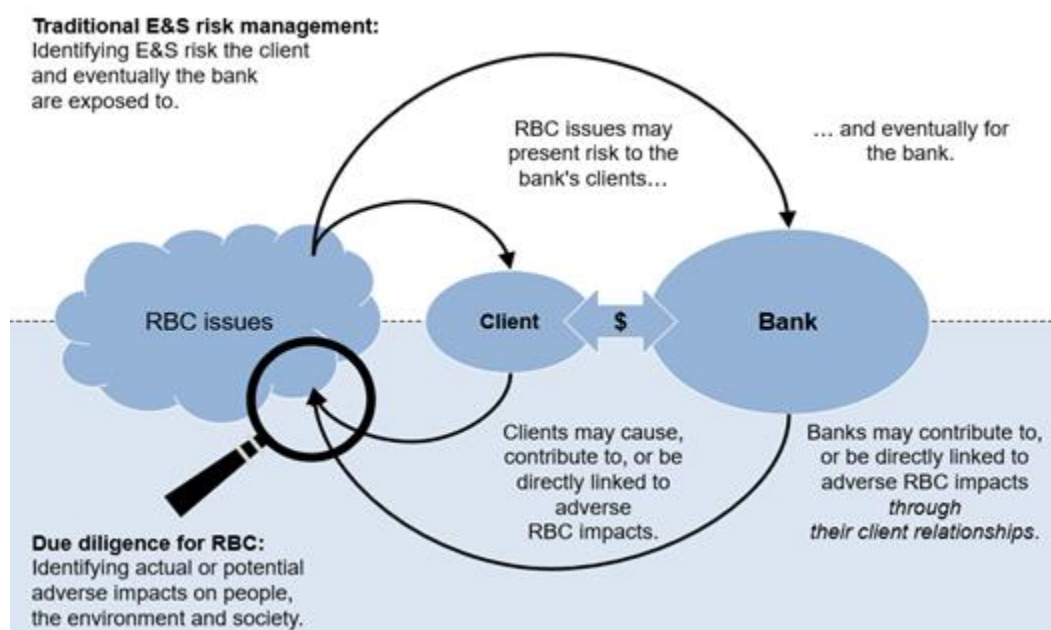
Readers should be aware of different meanings given to the same terms as these can lead to confusion and misunderstanding between banking professionals and stakeholders discussing RBC issues. (See 2.1.2. Annex A Terminology).

<sup>8</sup> Throughout this paper, passages of text in grey boxes are excerpts from the OECD Due Diligence Guidance for Responsible Business Conduct. See Ibid note 5.

## Adverse impacts and risk

Due diligence addresses actual adverse impacts or potential adverse impacts related to the following topics covered in the MNE Guidelines: human rights, including workers and industrial relations, environment, bribery and corruption, disclosure, and consumer interests (RBC issues). A risk of adverse impacts may exist when there is the potential for behaviour that is inconsistent with the recommendations in the MNE Guidelines because it involves impacts that may occur in the future.

Figure 1.2. Due diligence for RBC: An outward facing approach



In banking, the term “environmental and social risk (E&S risk)” is often used to describe how RBC issues may impact clients and eventually the bank. “RBC” and “E&S” criteria both relate to environmental and social considerations. However, for many banks, and enterprises more generally, the term “risk” means primarily risks to the enterprise – credit risk, market risk, operational risk, reputational risk, etc. Banks are concerned about their position in the market, in relation to their competitors, their image and long-term existence, so when they look at E&S risk, it is typically also through the lens of what risks environmental and social impacts pose to the bank and its shareholders.

The MNE Guidelines however refer to adverse impacts on people, the environment and society that enterprises and banks may cause, contribute to, or to which they are directly linked (“RBC risks”). In other words, it is an outward facing approach to risk. Consideration of RBC risk independently of its financial or commercial impact may represent a paradigm shift for some banks, although in many instances, there will be a strong correlation between the potential financial risk and RBC risk associated with a client and/or transaction. Nonetheless, many RBC issues persist precisely because they are not seen to be financially material or because their financial impact is realised over longer time scales. (See 2.1.2. Annex A Terminology).

## Why carry out due diligence?

Due diligence for RBC should help enterprises anticipate and prevent or mitigate adverse impacts. In some limited cases, due diligence may help them decide whether or not to go ahead with or discontinue operations or business relationships as a last resort, because the risk of adverse RBC impacts is too high or because mitigation efforts have not been successful.

Effectively preventing and mitigating adverse impacts may, in turn, help banks increase their positive contributions to society, improve stakeholder relationships, and protect their reputation. Due diligence can also help banks to create more value for their clients, as well as for society, over the short and longer terms. In some cases, instituting due diligence can facilitate identifying opportunities to reduce cost, improve understanding of markets, strengthen management of company-specific business and operational risks, decrease the probability of default, avoid incidents relating to matters covered by the MNE Guidelines, and decrease exposure to systemic risks. Banks can also carry out due diligence to help it meet legal requirements pertaining to specific RBC issues, such as local labour and environmental laws, reporting requirements and legal requirements mandating due diligence for certain risks which are increasingly common.

## Characteristics of due diligence – the essentials

**Due diligence is preventative** – The purpose of due diligence is first and foremost to *avoid* causing or contributing to adverse impacts on people, the environment and society, and to seek to prevent adverse impacts directly linked to operations, products or services through business relationships. When involvement in adverse impacts cannot be avoided, due diligence should enable enterprises to mitigate them, prevent their recurrence and, where relevant, remediate them.

In the context of corporate lending and securities underwriting, a preventative approach to adverse impacts may mean having strong ex-ante due diligence processes in place to avoid providing financing or securities underwriting services to client activities that cause, contribute to, or are linked to significant adverse RBC impacts. It may also mean getting involved to support efforts at addressing systemic issues or root causes of impacts where they are particularly significant.

This could entail, for example, providing innovative products to incentivise clients operating in high-risk sectors or geographies to implement due diligence (e.g. sustainability rating-linked loans with due diligence criteria may contribute towards preventing harm.) (See Measure 3: Cease, prevent and mitigate adverse impacts, Practical actions).

Due diligence will invariably involve a process of progressive improvement. While a bank's due diligence processes may not be able to prevent all adverse impacts associated with its activities and business relationships, they nonetheless should use reasonable good faith efforts, taking into account risk-based prioritisation to prevent impacts to the extent possible.



**Due diligence involves multiple processes and objectives** – The concept of due diligence under the MNE Guidelines involves a bundle of interrelated processes to identify adverse impacts, prevent and mitigate them, track implementation and results and communicate on how adverse impacts are addressed with respect to the enterprises' own operations, their supply chains, clients, and other business relationships.

Due diligence should be an integral part of banks' decision-making and risk management. It should enable the bank to be vigilant throughout the entire life cycle of the client relationship. In practice, this means various units of a bank may be involved in implementing due diligence processes. For example, this may involve integrating RBC approaches and concepts into traditional transactional or “know your customer” (“KYC”) due diligence processes, or integrating RBC analysis into screening loan portfolios and periodically reviewing individual client relationships, and credit processes although this might necessitate a redesign of the credit processes as currently few banks integrate RBC analysis into this process.

**Due diligence is commensurate with risk (risk-based)** – Due diligence is risk-based. The measures that an enterprise takes to conduct due diligence should be commensurate to the severity and likelihood of the adverse impact. When the likelihood and severity of an adverse impact is high, then due diligence will be more extensive. Due diligence should also be adapted to the nature of the adverse impact on RBC issues, such as on human rights and the environment. This involves tailoring approaches for specific risks and taking into account how these risks affect different groups, such as applying a gender perspective to due diligence.

Some types of client operations, products or services are more likely to be linked to RBC risks. Similarly, some contexts or circumstances (e.g. rule of law issues, lack of enforcement of standards, behaviour of business relationships) may heighten the risk of adverse impacts. As such banks should devote more time and resources to enhanced due diligence on clients associated with high-risk sectors, activities or contexts and may have less extensive processes for low-risk clients.

**Due diligence can involve prioritisation (risk-based)** – Where it is not feasible to address all identified impacts at once, an enterprise should prioritise the order in which it takes action based on the severity and likelihood of the adverse impact, rather than on commercial criteria. The significance, or severity, of an adverse impact is understood as a function of its scale, scope and irremediable character.

- Scale refers to the gravity of the adverse impact.
- Scope concerns the reach of the impact, for example the number of individuals that are or will be affected or the extent of environmental damage.
- Irremediable character means any limits on the ability to restore the individuals or environment affected to a situation equivalent to their situation before the adverse impact.

The MNE Guidelines themselves do not attempt to rank the severity of adverse impacts. It is not necessary for an impact to have more than one of these characteristics to be considered ‘severe’, although it is often the case that the greater the scale or the scope of an impact, the less it is ‘remediable’. Severe impacts may include hazardous working conditions that are common in a certain sectors, or extensive environmental degradation which threatens the livelihood and health of local communities.

The process of prioritisation is ongoing, and in some instances new or emerging adverse impacts may arise and be prioritised before moving on to less significant impacts.

In the case of prioritising risks to human rights, the severity of a potential adverse impact, such as where a delayed response would make the impact irremediable, is the predominant factor in prioritising responses.

Once the most significant impacts are identified and dealt with, the enterprise should move on to address less significant impacts. Where an enterprise is causing or contributing to an adverse impact on RBC issues, it should always stop the activities that are causing or contributing to the impact and provide for or cooperate in their remediation.

Banks will often have large numbers of clients and may be exposed to a diverse range of actual or potential adverse impacts. As such, banks will find it helpful to identify general areas where the risk of adverse impacts is most significant and prioritise accordingly. This may be done through the screening of clients based on risk factors, as is already common practice for many banks. (See Measure 2: Identify and assess actual and potential adverse impacts) RBC policies will be important in shaping and communicating a strategy and rationale for prioritising risks. Such prioritisation can also inform the bank's position on specific RBC issues, particularly in high-risk sectors and geographies. Importantly, prioritisation decisions should be based on the severity and likelihood of the RBC impact, rather than driven by commercial considerations. This process will invariably involve supposition and judgment calls by the bank on a variety of issues, such as the severity of a potential impact, or in evaluating the comparative significance of different impacts across clients, sectors or geographies. Consulting with stakeholders in prioritisation decisions and communicating on those judgment calls publicly will strengthen the credibility of, and trust in, a bank's due diligence. (See Measure 1: Embed RBC into policies and management systems).

**Due diligence is dynamic** – The due diligence process is not static, but ongoing, responsive and changing. It includes feedback loops so that the enterprise can learn from what worked and what did not work. Enterprises should aim to progressively improve their systems and processes to avoid and address adverse impacts. Through the due diligence process, an enterprise should be able to adequately respond to potential changes in its risk profile as circumstances evolve (e.g. changes in a country's regulatory framework, emerging risks in the sector, the development of new products or new business relationships).

In the context of corporate lending and securities underwriting, a dynamic approach to due diligence may mean reviewing prioritisation approaches as new issues are identified, updating company watch-lists (or “RBC [or E&S] monitoring lists”) based on identified risks associated with (potential) clients, strengthening approaches for preventing impacts such as including expectations around RBC into contracts or other written agreements with clients.

**Due diligence does not shift responsibilities** – Each enterprise in a business relationship has its own responsibilities to identify and address adverse impacts. The due diligence recommendations of the MNE Guidelines are not intended to shift responsibilities from governments to enterprises, or from enterprises causing or contributing to adverse impacts to the enterprises that are directly linked to adverse impacts through their business relationships. Instead, the MNE Guidelines recommend that each enterprise addresses its own responsibility with respect to adverse impacts, and in cases where impacts are directly linked to an enterprise’s operations, products or services, seeks to use its leverage, to the extent possible, individually or in collaboration with others to effect change.

A relationship between a bank and a client is considered a “business relationship” under the MNE Guidelines. As a result, banks are expected to consider and act on RBC risks throughout their corporate lending and securities underwriting activities and, where relevant, to use their leverage with their clients to influence them to prevent or mitigate adverse impacts. Banks are only responsible for addressing adverse impacts themselves when they cause or contribute to those impacts (See Measure 2: Identify and assess actual and potential adverse impacts). Where the bank is directly linked to an adverse impact through a client, but does not cause or contribute to it, the bank will not be responsible for remedying the impact. However, 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. (See Measure 3: Cease, prevent and mitigate adverse impacts, Practical actions).

**Due diligence concerns internationally-recognised standards of RBC** – The MNE Guidelines provide principles and standards of RBC consistent with applicable laws and internationally-recognised standards. They state that obeying domestic laws in the jurisdictions in which the enterprise operates and/or where they are domiciled is the first obligation of enterprises. Due diligence can help enterprises observe their legal obligations on matters pertaining to the MNE Guidelines. In countries where domestic laws and regulations conflict with the principles and standards of the OECD Guidelines, due diligence can also help enterprises honour the MNE Guidelines to the fullest extent which does not place them in violation of domestic law. Domestic law may also in some instances require an enterprise to take action on a specific RBC issue (e.g. laws pertaining to specific RBC issues such as foreign bribery, modern slavery or minerals from conflict-affected and high-risk areas).

The approaches in this paper are without prejudice to legal obligations. The Guidelines extend beyond domestic law in many cases, but are not intended to conflict with legal obligations of banks. In case of a conflict between national laws and the MNE Guidelines, banks “should seek ways to honour [MNE Guidelines] principles and standards to the fullest extent which does not place them in violation of domestic law”.<sup>9</sup> To the extent that domestic laws truly contradict the principles and standards promoted in the MNE Guidelines, the banks may have to reconsider operating in that jurisdiction, or reconsider providing general corporate loans or underwriting securities to clients operating in that jurisdiction.

Banks should first and foremost respect the laws of the jurisdiction they operate in, including in the context of corporate governance obligations and duties to their clients and shareholders. For example, banks in certain jurisdictions must respect duties of client confidentiality. However, banks can still take steps to promote greater transparency with respect to client relationships without being in breach of this duty (see Box 1.1). Additionally, in some jurisdictions, banks may interpret laws or regulations as setting limitations on how they can influence client conduct. All recommendations in this guidance related to the use of leverage should be considered within the parameters of what is legally permissible, which may include, where relevant, seeking consent from clients. Finally, competition law issues should be understood and taken into account with respect to collaborative due diligence approaches.<sup>10</sup>

<sup>9</sup> OECD Guidelines for Multinational Enterprises (2011), Chapter I, para 2

<sup>10</sup> For further guidance on the intersection of RBC and Competition Law issues see Capobianco, Gillard and Bijelic (2015), “Competition law and responsible business conduct”, Background Note for the 2015 Global Forum on Responsible Business Conduct, OECD, Paris, <https://mneguidelines.oecd.org/global-forum/2015GFRBC-Competition-background-note.pdf>

### Box 1.1. A Bank's Duty of Client Confidentiality

Many jurisdictions have legal frameworks, which recognise that a bank has a legal duty to keep its clients' affairs confidential. The scope of the duty may differ considerably from one country to another, and will vary depending on the law governing the relationship between banks and their clients. For example, while this duty does not exist in the United States, it is recognised in the UK and most other European countries under civil law. Moreover, in Switzerland and Singapore, violating obligations of client confidentiality can be a criminal offence. Where it exists, a bank's duty of client confidentiality generally covers more than just financial information (for example, the state of the client's account) and extends to all information received in the course of the relationship. It may also require the bank to keep confidential the existence of the client relationship itself. The duty usually applies to information received about prospective clients and can continue after a client relationship has ended.

Most jurisdictions also recognise specific circumstances where a bank may be permitted to disclose confidential information about a client. For example, in the UK these circumstances include where:

- the bank is compelled by law to disclose the information (for example, where a bank representative is required to give evidence relating to the client in court proceedings).
- the bank has a public duty to disclose the information (for example, where disclosure is necessary to prevent fraud or other crimes);
- the interests of the bank require disclosure (for example, where the bank sues the client for payment of an overdraft); or
- disclosure is made in accordance with the express or implied consent of the customer (for example, where the customer asks the bank to give information to a third party).

How these exceptions apply in practice will depend on the specific jurisdiction and the facts of each particular case. Over the years, an increasing number of statutory exceptions to a bank's duty of confidentiality have been introduced in most jurisdictions, for example to prevent money laundering, terrorist financing, and tax evasion).

In the context of due diligence, client confidentiality duties can be a challenge for banks when collaborating with one another in identifying real and potential adverse impacts associated with clients and applying leverage (see Box 1.2 and Measure 3: Cease, prevent and mitigate adverse impacts), engaging with stakeholders (see Characteristics of due diligence and Measure 5: Communicate how impacts are addressed), communicating on their due diligence activities (see Measure 5: Communicate how impacts are addressed), and cooperating in processes to enable remediation (see Measure 5: Communicate how impacts are addressed).

The duty of confidentiality is owed by the bank to the client and is intended to protect the client's interests. This means that generally the client can waive the right to confidentiality with respect to their information. Accordingly, one way to respond to client confidentiality restrictions is to obtain (ideally at the outset of the relationship) the consent of the client to disclose specific information; for example, the existence of the client relationship with the bank. In cases where a bank has identified an adverse impact associated with one of its

client's business activities during the course of the relationship, a bank may seek the client's consent to disclose further specific information as relevant.

These approaches have already been successfully applied by some banks in the context of reporting on environmental and social risks (see Measure 5: Communicate how impacts are addressed).

When seeking consent from a client it will be important for the bank to be clear about exactly what information it is permitted to disclose, to whom and in what circumstances. It is also important to know exactly which legal entity is giving consent and whether it has the authority to give consent on behalf of other legal entities in a group. It may be useful to standardise the process for requesting client consent on these issues; for example, through the inclusion of a provision in the standard language of loan covenants or having client relationship managers raise it with prospective clients as a matter of practice during the client on-boarding process (and then ensuring that any agreement is recorded in writing).

Currently broadly used template covenant agreements, such as that of the Loan Markets Association, do not include such provisions; modifying such template agreements to include client consent to disclose the existence of the client relationship would be very useful to standardising this practice.

**Due diligence is appropriate to an enterprise's circumstances** – The nature and extent of due diligence can be affected by factors such as the size of the enterprise, the context of its operations, its business model, its position in supply chains, and the nature of its products or services. Large enterprises with expansive operations and many products or services may need more formalised and extensive systems than smaller enterprises with a limited range of products or services to effectively identify and manage risks.

In the context of corporate lending and securities underwriting, the nature and extent of due diligence may also depend on the nature of the bank and the structure of its portfolio as well as the nature of its clients (e.g. whether clients are government or private entities). It may also depend on the characteristics of a transaction. For example, the longevity of a relationship with a client and whether the bank is participating in a syndicated transaction (as a lead or member) or involved in a bilateral transaction may both influence how the bank will identify RBC risks and impacts associated with the client and how the bank can exercise meaningful influence on the client. (See Box 4).

**Due diligence can be adapted to deal with the limitations of working with business relationships** – Enterprises may face practical and legal limitations to how they can influence or affect business relationships to cease, prevent or mitigate adverse impacts on RBC issues or remedy them. Enterprises, in particular SMEs, may not have the market power to influence their business relationships by themselves. Enterprises can seek to overcome these challenges to influence business relationships through contractual arrangements pre-qualification requirements, voting trusts, license or franchise agreements, and also through collaborative efforts to pool leverage in industry associations or cross-sectoral initiatives.

Banks, like all enterprises, may face practical limitations to how they can influence their client to cease, prevent or mitigate adverse impacts on RBC issues or remedy them. For example, in competitive markets, banks face limitations on their ability to influence clients or prospective clients, and may stand to lose clients as a result of requiring certain information or standards of conduct, which may extend the timeline of the transaction, where other banks have lower requirements in place. Additionally, in some jurisdictions, there may be legal issues concerning the influence of banks on the conduct of the boards or management of their clients. However, even in these cases, banks can still promote RBC through engagement with their clients, raising points and concerns regarding RBC issues with them and, in some cases, discontinue relationships with clients that continue to cause or contribute to adverse impacts. (See Measure 3: Cease, prevent and mitigate adverse impacts). Banks can also seek to overcome leverage limitations through contractual arrangements, collaborative efforts to pool leverage with other banks or other units within a bank, or contribute to cross-sectoral initiatives. (See Measure 3: Cease, prevent and mitigate adverse impacts).

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.

What is appropriate will vary according to the characteristics of the bank, its client and its client's operating context, the risk or impact in question, the lending or securities underwriting arrangement and relevant regulatory obligations.

**Due diligence is informed by engagement with stakeholders** – Stakeholders are persons or groups who have interests that could be affected by an enterprise's activities. Stakeholder engagement is characterised by two-way communication. It involves the timely sharing of the relevant information needed for stakeholders to make informed decisions in a format that they can understand and access. To be meaningful, engagement involves the good faith of all parties. Meaningful engagement with relevant stakeholders is important throughout the due diligence process. In particular, when the enterprise may cause or contribute, or has caused or contributed, to an adverse impact, engagement with impacted or potentially impacted stakeholders and rights holders will be important. For example, depending on the nature of the adverse impact being addressed, this could include participating in and sharing results of on-site assessments, development of risk mitigation measures, ongoing monitoring and the design of grievance mechanisms.

Stakeholders of banks may include a wide range of actors including their employees, clients, shareholders, as well as regulators, industry peers, and civil society and rights-holders<sup>11</sup> where they operate and where impacts are felt.

<sup>11</sup> The OECD Guidelines refer to the term 'rights-holder' in the context of human rights. Therefore, this Guidance uses the term rights-holder in the context of stakeholders subject to real or potential human rights impacts. This is without prejudice to other 'rights' such as land rights etc. See OECD Guidelines for Multinational Enterprises, Chapter IV Paragraph 45. There may be several groups of

Seeking and integrating input or feedback from stakeholders can help banks ensure that their due diligence processes are effective. For example, see Table 1.1. Engagement with all stakeholder groups will not be relevant in all circumstances.

**Table 1.1. Engagement with stakeholders to inform due diligence**

Due diligence actions	Suggested stakeholders to engage
Developing RBC polic(ies) and making decisions about which impacts to prioritise across portfolios.	Contractual stakeholders (i.e. employees, clients and shareholders) Regulators Experts (e.g. environmental, social and human rights consultants, academia, civil society organisations and global trade unions)
Identifying and assessing actual and potential impacts associated with clients, developing general prevention and mitigation strategies (not linked to a specific client, and designing remediation mechanisms.	Experts (e.g. environmental, social and human rights consultants, academia, specialised ESG rating agencies), industry associations, civil society organisations or global trade unions) <sup>12</sup> and legitimate representatives of impacted rights-holders, where appropriate.
In cases where a bank has contributed to an adverse impact: Identifying appropriate forms of remedy or in communicating back on how actual human rights impacts are being addressed. Devising prevention and mitigation strategies with respect to ongoing impacts linked to a specific client.	Impacted rightsholders Legitimate representatives of impacted rights-holders (e.g. trade unions, or community leaders) or credible proxies (e.g. civil society organisations or independent experts).

As a starting point, banks should encourage their clients to engage in meaningful stakeholder engagement with rightsholders that are or may be impacted by their operations. For high-risk clients or activities, banks can go further and assess the quality of a client's stakeholder engagement in line with international standards.<sup>13</sup> Specifically, this may include a review of the records of engagement for a specific asset as well as stakeholder mapping and strategy to improve the quality of their client's stakeholder engagement activities. In circumstances where the bank deems the client's engagement with rightsholders to be unsatisfactory, the bank may determine, for example with the help of an independent consultant, whether or not engagement has been appropriate and, where engagement is deemed unsatisfactory, identify actions that the client should take to address any shortcomings.

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. In these

'rights-holders' associated with the activities of a company e.g. employees, people to be resettled, local communities etc.

<sup>13</sup> See for example OECD (2016c), OECD Due Diligence Guidance for Meaningful Stakeholder Engagement in the Extractive Sector, <http://mneguidelines.oecd.org/stakeholder-engagement-extractiveindustries.htm>; and further guidance in OECD (2018) Due Diligence Guidance for Responsible Business Conduct, Annex q. 8-11



situations, the bank will generally have an existing relationship with a client and the engagement would be undertaken in collaboration with the relevant client.

Banks can also participate in multi-stakeholder platforms to have access to complaints submitted by impacted stakeholders or rightsholders<sup>14</sup> and establish mechanisms at a headquarters level to allow stakeholders or rightsholders to raise issues with the bank about impacts associated with their clients. (See Measure 6: Provide for or cooperate in remediation when appropriate).

**Due diligence involves ongoing communication** – Communicating information on due diligence processes, findings and plans is part of the due diligence process itself. It enables the enterprise to build trust in its actions and decision-making, and demonstrate good faith. Enterprises should account for how they identify and address actual or potential adverse impacts and should communicate accordingly. Information should be accessible to its intended audiences (e.g. stakeholders, investors, consumers etc.) and be sufficient to demonstrate the adequacy of an enterprise's response to impacts. Communication should be carried out with due regard for commercial confidentiality and other competitive<sup>15</sup> or security concerns. Various strategies may be useful in communicating to the extent possible while respecting confidentiality concerns.

Banks can communicate on due diligence approaches for corporate lending and securities underwriting through annual reporting, sustainability reports, their website or other means. This reporting may be done on an aggregate or anonymous basis where client confidentiality requirements cannot be overcome through securing client consent to communicate on activities or issues specific to the client. In cases where a bank is causing or contributing to a human rights impact, they should be prepared to communicate relevant information to impacted rightsholders in a timely, culturally sensitive and accessible manner while respecting client confidentiality. (See Measure 5: Communicate how impacts are addressed).

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<sup>14</sup> One example of this is Roundtable on Sustainable Palm Oil (RSPO)

<sup>15</sup> Competitive concerns should be interpreted in light of applicable competition law.

### **Box 1.2. Collaboration in carrying out due diligence**

Enterprises can collaborate across various departments at an industry or multi-industry level as well as with relevant stakeholders throughout the due diligence process, although they always remain responsible for ensuring that their due diligence is effectively carried out. For example, collaboration may be pursued in order to pool knowledge, increase leverage and scale-up effective measures. Cost sharing and savings are often benefits of collaboration and can be particularly useful for SMEs. While in many cases, enterprises can collaborate on due diligence without breaching competition law, enterprises, and the collaborative initiatives in which they are involved, are encouraged to take proactive steps to understand competition law issues in their jurisdiction and avoid activities which could be seen as breaches of competition law.

In the context of banks, where clients, or other counterparts, are carrying out due diligence, it may be sufficient for the bank to assess the quality and reliability of those efforts and then determine whether supplementary action is needed, as part of its own due diligence, rather than replicating the efforts of others. For example:

- In the context of syndicated lending transactions, when a syndicate has agents and lead arrangers with their own robust due diligence practices, the overall group will benefit from smoother due diligence as relevant RBC documentation will likely be already prepared and available to the syndicate.
- If a bank has clients that can demonstrate they are adequately carrying out due diligence and identifying RBC risks, the bank may not need to further identify risks with regard to those companies. Instead, the bank might focus on engaging with the client to track how real or potential impacts are being appropriately responded to.
- Banks can also collaborate with relevant teams in the bank to promote efficiency with respect to due diligence and to increase leverage. For example, in situations where a bank identifies a significant impact in the context of a general corporate lending transaction it may check to see whether the bank is also providing other types of banking services to the company (i.e. advisory, project or asset based finance etc.). It can then seek to build off or combine with the due diligence activities of teams in the banking department, subject to restrictions on internal information sharing, including in applying leverage where options with respect to a specific transaction may be limited.

Where banks collaborate on due diligence, they should ensure they undertake their own independent assessment of the adequacy of due diligence taken by others rather than relying solely on assurances provided by others.

## Chapter 2. Key considerations for RBC due diligence in banking transactions

This section is divided into six parts, each of which corresponds to a step of the due diligence process:

- Embedding RBC into policies and management systems;
- Identifying actual and potential adverse RBC impacts;
- The cessation, prevention, and mitigation of such impacts;
- Tracking implementation and results;
- Communicating how impacts are addressed; and
- Providing for or cooperating in remediation when appropriate.

Each section begins with a box that outlines the core elements of the due diligence process as articulated in the OECD Due Diligence Guidance for Responsible Business Conduct. Each section also includes an overview of practical actions, which illustrate how to implement or adapt as needed supporting measures for due diligence as well as a discussion of key considerations, which may be relevant to applying specific due diligence steps in the context of corporate lending and securities underwriting.

### Measure 1: Embed RBC into policies and management systems

1.1. Devise, adopt and disseminate a combination of policies on RBC issues that articulate the enterprise's commitments to the principles and standards contained in the MNE Guidelines and its plans for implementing due diligence, which will be relevant for the enterprise's own operations, its supply chain and other business relationships.

1.2. Seek to embed the enterprise's policies on RBC issues into the enterprise's oversight bodies. Embed the enterprise's policies on RBC issues into management systems so that they are implemented as part of the regular business processes, taking into account the potential independence, autonomy and legal structure of these bodies that may be foreseen in domestic law and regulations.

1.3. Incorporate RBC expectations and policies into engagement with suppliers and other business relationships.

<p>Practical actions for banks</p>	<p>Adopting a policy which includes commitment by the bank to observe relevant principles and standards on RBC issues (e.g. the MNE Guidelines, the UN Guiding Principles on Business and Human Rights) and:</p> <ul style="list-style-type: none"> <li>– describes the bank’s approach to due diligence and lays down principles and criteria informing risk identification, prevention and mitigation, and explains how the bank prioritizes RBC issues (i.e. why some RBC issues are considered more significant than others);</li> <li>– ensures a consistent approach to due diligence and decision making across the entire bank (i.e. in the context of different transactions and departments);</li> <li>– clearly communicates the bank’s expectations towards its clients (i.e. through policies or engagement on specific identified risks)</li> <li>– describes the bank’s approach to stakeholder engagement; and</li> <li>– covers all types of client relationships within the scope of this paper, across different business areas as well as across different geographies and industry sectors.<sup>16</sup></li> </ul> <p>Identifying and assigning roles to relevant business units for carrying out steps of the due diligence process (e.g. boards and senior level management, risk or compliance teams, business development officers and client relationship managers, marketing leads for shares and bonds [for underwriting]).</p> <p>Allocating sufficient resources to effectively carry out due diligence.</p> <p>Maintaining management systems which enable banks to consider RBC risks (as defined in this paper) in business strategies and daily operations (e.g. tools to enable risk identification and assessment, knowledge management systems, processes for internal reporting, integration of RBC objectives into performance assessments of deal teams, etc.).</p> <p>Communicating RBC expectations to clients, specifically:</p> <ul style="list-style-type: none"> <li>– an expectation that clients should operate in accordance with relevant international RBC frameworks (e.g. MNE Guidelines), including the expectation that remedy is provided where a client causes or contributes to adverse impacts;</li> <li>– conditions for the provision of finance (e.g. requiring a commitment to comply with relevant international standards);</li> <li>– circumstances related to RBC in which a business relationship with a client may be terminated; and</li> <li>– seeking consent from a client to disclose the client’s relationship to the bank where practicable in the context of the due diligence process (see Box 1.1)</li> </ul>
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### *What is the purpose of policies on RBC?*

Policies on RBC issues (“RBC policies”, also referred to as “ESG policies” or “CSR policies”) are used to clearly articulate what the bank expects from clients and staff in relation to RBC issues and to inform the design of RBC processes.

This may include due diligence processes as well other processes of a bank (e.g. client on boarding, audit functions, etc.). Policies on RBC also serve to inform the broader public about what the bank’s position on RBC issues is.

<sup>16</sup> Recognising that within the scope of this paper only general corporate lending and securities underwriting transactions are considered.

***What should the scope of applicability be for RBC policies?***

Sometimes RBC policies of banks include applicability thresholds. For example, the Equator Principles, an environmental and social risk management framework used for asset-specific corporate loans, only apply when a series of conditions are fulfilled, including monetary thresholds. However, the due diligence approach recommended under the MNE Guidelines is not triggered by monetary thresholds, but applies to all transactions, using a risk-based approach. The size of a loan may affect a bank's risk exposure and how aspects of the due diligence process are carried out in practice, but RBC policies should, in principle, apply to all transactions regardless of their monetary value or duration.

***Which format can RBC policies have?***

An RBC policy does not need to be a standalone or single document. It can be a collection of policies and can be integrated into existing documents, such as policies, statements or commitments of a bank, due diligence forms, contract templates or other forms of agreements used in the course of managing client relationships. Banks will normally integrate RBC issues into overarching policies (e.g. a credit risk policy or a reputational risk management policy).

Banks normally also establish industry and issue specific policies or policy statements in which they explain how they address RBC issues at the levels of client, transaction, and portfolio. For example, banks often have stand-alone policies that address RBC issues in the context of specific industry sectors, such as mining and agriculture, in addition to general policies regarding corporate social responsibility.

To ensure that clients, prospective clients and other stakeholders can easily understand and access RBC policies, it is important that they be clearly worded, available in the most important languages spoken in the key markets the bank operates in and in formats that are accessible to a wide audience.

Owing to the broadness and complexity of RBC issues that the bank might be involved with, banks can use their policy-making and revision processes to communicate the rationale or approach they use to prioritise high-risk issues (i.e. the considerations the bank took into account in assessing which impacts are most significant). For example, a bank may flag in their policies that forced labour risks are a priority for them, given the significant scale and scope of these impacts, as well as signals from regulators that this is a priority issue.<sup>17</sup>

***How can RBC policies be developed and revised?***

Model policies already exist for management of RBC risks, including with respect to specific issues or sectors.<sup>18</sup> Banks may wish to build on or adapt existing policies to ensure they are appropriate to their context and risk profile.

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<sup>17</sup> For examples of approaches to risk prioritization see OECD Due Diligence Guidance, Ibid note 2, Q 3-5 and Shift (2014) Business and Human Rights Impacts: Identifying and Prioritizing Human Rights Risks, [https://shiftproject.org/wp-content/uploads/2014/01/Shift\\_SERworkshop\\_identifyHRrisks\\_2014.pdf](https://shiftproject.org/wp-content/uploads/2014/01/Shift_SERworkshop_identifyHRrisks_2014.pdf)

<sup>18</sup> For example, see “Model Supply Chain Policy for a Responsible Global Supply Chain of Minerals from Conflict-Affected and High-Risk Areas”, OECD Due Diligence Guidance for Minerals Sourced from Conflict Affected and High Risk Areas; See also “Model Enterprise Policy for

Consultation with stakeholders, such as bank's employees, clients, regulators, shareholders, industry peers and civil society organisations is also useful in developing RBC policies and particularly in developing a rationale for prioritisation. Some of these stakeholders may have expertise or broader understanding of the various impacts a bank may be linked to through its clients' activities and operations and thus be well placed to provide informed views on how to prioritise amongst them. Consulting external stakeholders (such as civil society organisations) also helps to establish credibility with respect to a bank's prioritisation decisions.

Additionally, consulting with relevant units of the bank (see Measure 1: Embed RBC into policies and management systems) in the context of policy development can help identify realistic RBC objectives and policy implementation approaches that both are effective and can be easily integrated into a bank's regular operations.

Banks may also wish to set the frequency for periodic updates to make sure that the policies reflect changes in the risk and business landscape, shifting societal expectations, regulatory obligations and lessons learned.

***Which teams or business units will be relevant to consider when developing and aligning objectives with the banks' RBC policies?***

In order to implement an effective due diligence process and ensure alignment with respect to RBC policies and due diligence processes, banks should identify which business units will be relevant to carrying out the steps of a due diligence approach (such as developing RBC policies and management systems for implementing them, including for the identification, prevention and mitigation of impacts). It is important to then assign roles, responsibilities and adequate resources across all relevant units and departments.

Relevant staff or business units of banks include:

- Those making high-level decisions (e.g. boards and senior-level management).
- Those in charge of risk or compliance (e.g. legal, compliance, due diligence officers, credit officers, risk units, Environmental and Social Risk units).
- Those developing and managing client relationships (e.g. business development officers, client relationship managers).
- In the context of underwriting, those in charge of marketing the shares and bonds that the bank is underwriting.

It will also include units from different business areas, such as commercial and investment banking. Due diligence processes are also relevant for non-traditional financial products and services, which are designed to include environmental and social objectives.

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Responsible Agriculture Supply Chains”, OECD-FAO (2018) Guidance on Responsible Agricultural Supply Chains.

*What management systems can banks establish to facilitate carrying out due diligence?*

It is important to establish and maintain appropriate and sound management systems that enable banks to consider RBC issues in their business strategies and daily operations.<sup>19</sup>

As an initial consideration, sufficient financial resources should be allocated or available to ensure the establishment of management systems and due diligence activities (e.g. budget for the development and use of in-house impact identification tools on a permanent basis, allowance for field travel when necessary, to budget for staff responsible for responding to and tracking real and potential impacts, etc.).

Some due diligence activities may be integrated into existing processes and tools, provided that they go beyond simply identifying and managing material risks to the company itself, to include risks of adverse impacts as understood under the MNE Guidelines. As discussed above, for some banks this may represent a significant change in current thinking and approaches for banks.

For example, where relevant and useful, the identification and assessment of actual or potential adverse RBC impacts can be integrated into processes such as client on-boarding, transactional due diligence, and periodic reviews, led by relationship managers, due diligence officers, credit officers and other functions. However, it is important to note that environmental and social issues often require nuanced assessment of qualitative information and therefore may not be adequately considered in processes designed to process large amounts of quantitative information.

Additionally, building on existing due diligence processes which address corruption risks can contribute to identifying other issues under the MNE Guidelines in an efficient way. This is especially relevant as there is increasing recognition of the linkages between corruption risks and environmental and social issues – corruption can undermine environmental protection or represent a red flag with regard to workplace health and safety risks. This may involve including basic questions on human rights and environmental issues in KYC processes or client screening activities and using this information to provide an initial indication of the degree of due diligence needed moving forward in that client relationship.

Specific processes and tools may also need to be established to facilitate carrying out due diligence. For example:

- Banks should provide staff in charge of identification of RBC risks with relevant tools to enable identification and assessment of impacts. This might include access to market research services which identify RBC issues, training for or hiring of internal staff to ensure in-house expertise to identify, assess and manage RBC issues appropriately.
- To aid efficient identification of impacts, banks can develop simple questionnaires regarding RBC issues with binary answers that can be completed quickly by relationship managers, or compliance/credit managers to gather initial, preliminary information (e.g. does the company have staff responsible for environmental and

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<sup>19</sup> OECD Guidelines, Chapter IV, paragraph 4, and Commentary, paragraph 44; OECD Guidelines, Chapter VI, Commentary, paragraph 63.

human rights risk management? etc.) The responses can be used to flag where additional assessment may be needed.

- In order to further facilitate identification and to track the effectiveness of due diligence processes, banks may establish a knowledge management system or “RBC monitoring lists” (e.g. for record-keeping on RBC issues, activities, and decision-making). This may include: a) a register of RBC risks identified in relation to individual companies and projects (including RBC risks or incidents reported through grievance mechanisms); b) assessments of clients’ RBC performance; and c) documentation of decisions to form or end a business relationship with a client including conditions which may have been stipulated; and records of engagement with prospects, clients, and other relevant stakeholders on RBC issues.
- In order to ensure that RBC issues are adequately responded to, banks can establish criteria for decision making with respect to RBC issues as well as processes for internal reporting and escalation of issues up to senior management to ensure they are taken into account and responded to.
- To ensure alignment with RBC policies across different functions, it will be important to align incentives and develop systems to prevent conflict of interest, so a bank’s due diligence teams are shielded from any internal pressures to overlook RBC risks in favour of commercial outcomes. Measures may include, establishing internal risk controls and internal audits and strengthening internal whistle-blower protections where such controls are not successful and the integration of RBC objectives into performance assessments, and compensation incentives for relevant teams and final decision making bodies. (See Measure 1: Embed RBC into policies and management systems).

### *What is the role of senior management<sup>20</sup> in the context of RBC policies?*

Senior management plays a crucial role in ensuring that policies on RBC issues are implemented coherently across the organisation.<sup>21</sup> Senior management will also ensure that the appropriate management systems, processes, and organisational structure to enable the bank to implement and maintain its RBC policy commitments effectively are in place.

The duty of senior management in overseeing issues relevant to RBC and stakeholders consultation is also recognised in the *G20/OECD Principles for Corporate Governance* (see Box 2.1).

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<sup>20</sup> Some banks deal with such issues at the executive board level, others at the board of director’s level, others, again, have specific committees which may include members from the executive board and/or board of directors.

<sup>21</sup> The Thun Group of Banks first discussion paper highlights that the “[t]one from the top’ is important in gaining buy-in from other parts of the organisation, especially when making explicit reference to human rights in a range of policies and integrating a human rights “perspective” on decisions and processes. Thun Group of Banks, Discussion Paper for Banks on Implication of the United Nations Guiding Principles on Business and Human Rights 16–21, October 2013, page 7.



**Box 2.1. G20/OECD Principles for Corporate Governance**

According to the G20/OECD Principles for Corporate Governance, the senior management body, such as a committee, ideally including members from the executive board and/or the board of directors should:

- oversee the risk management system and systems designed to ensure that the corporation obeys applicable laws, including tax, competition, labour, environmental, equal opportunity, health and safety laws;
- take due regard of, and deal fairly with, other stakeholder interests including those of employees, creditors, customers, suppliers and local communities. Observance of environmental and social standards is relevant in this context;
- have a key role in setting the ethical tone of a company, not only by its own actions, but also in appointing and overseeing key executives, and consequently, the management in general;
- establish and ensure the effectiveness of internal controls, ethics, and compliance programmes or measures to comply with applicable laws, regulations, and standards. [...] Moreover, compliance must also relate to other laws and regulations such as those covering securities, competition and work and safety conditions. Other laws that may be applicable include those relating to taxation, human rights, the environment, fraud, and money laundering.

### *How can RBC expectations be communicated to clients?*

A first step in communicating RBC expectations is to ensure that the bank's RBC policies are publicly available and actively communicated to the client. Banks should articulate their RBC expectations in a way that can be communicated to and understood by the companies the bank engages with.

In addition to communicating about general expectations on RBC (see practical actions under Measure 1: Embed RBC into policies and management systems), banks may also tailor their communication based on specific risks associated with the client. For example, in cases of securities underwriting, if a company in a carbon intensive industry does not consider climate change to be a risk because there is no foreseeable short-term impact on the company, the bank can play a role in explaining to the client the significant environmental and social risks that climate change poses and how it may also have a material impact on the client, for example due to changing investor sentiment and increasing regulation.

Communicating RBC expectations and requesting consent with respect to disclosing the client's relationship to the bank (see Box 1.1) should ideally initially take place prior to forming a business relationship, during the client on-boarding process, where practicable.

In order to ensure the bank and client company share an agreed common understanding of RBC expectations, they may be included where possible in financing contracts or underwriting agreements. This may be particularly important for high-risk clients (e.g. clients with a bad track-record on RBC, or clients operating in high risk sectors or geographies). To date, RBC expectations have not been included in template loan covenants developed by recognised market associations like the Loan Market Association, which has limited their inclusion in contractual agreements.

Tools (e.g. checklists and a set of RBC-related questions integrated into assessment tools), documentation (e.g. fact sheets, policy statements), and training on RBC issues can also support engagement on RBC expectations.

Additionally, RBC expectations should be predictable and not subject to factors such as the place of incorporation and ownership structure of a client. Under the MNE Guidelines, state-owned enterprises are subject to the same recommendations as privately-owned enterprises<sup>22</sup> and the recommendations of the Guidelines are relevant to enterprises irrespective of the country or specific context of enterprises' operations.<sup>23</sup> However, *how* a bank goes about checking and ensuring expectations are met, and the degree of leverage to prevent or mitigate impacts, will vary considerably according to various factors. (See Measure 1: Embed RBC into policies and management systems).

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<sup>22</sup> OECD Guidelines, Chapter II, Commentary, paragraph 10.

<sup>23</sup> Particularly, the expectation of the OECD Guidelines for Multinational Enterprises that enterprises “[s]eek to prevent or mitigate an adverse impact [...] directly linked to their operations, products or services by a business relationship” is not limited to business relationships based or operating in OECD countries. Therefore, the expectation that clients should operate in accordance with relevant international RBC frameworks (e.g. MNE Guidelines) should apply regardless of whether the client is based in or operating in an OECD country. OECD Guidelines, Chapter IV, Commentary, paragraph 39.

## Measure 2: Identify and assess actual and potential adverse impacts

2.1. Carry out a broad scoping exercise to identify all areas of the business, across its operations and relationships, including in its supply chains, where RBC risks are most likely to be present and most significant. Relevant elements include, among others, information about sectoral, geographic, product and enterprise risk factors, including known risks the enterprise has faced or is likely to face. The scoping exercise should enable the enterprise to carry out an initial prioritisation of the most significant risk areas for further assessment. For enterprises with less diverse operations, in particular smaller enterprises, a scoping exercise may not be necessary before moving to the stage of identifying and prioritising specific impacts.

2.2. Starting with the significant areas of risk identified above, carry out iterative and increasingly in-depth assessments of prioritised operations, suppliers and other business relationships in order to identify and assess specific actual and potential adverse RBC impacts.

2.3. Assess the enterprise's involvement with the actual or potential adverse impacts identified in order to determine the appropriate responses. Specifically, assess whether the enterprise: (a) caused (or would cause) the adverse impact; or (b) contributed (or would contribute) to the adverse impact; or whether (c) the adverse impact is (or would be) directly linked to its operations, products or services by a business relationship.

2.4. Drawing from the information obtained on actual and potential adverse impacts, where necessary, prioritise the most significant RBC risks and impacts for action, based on severity and likelihood. Prioritisation will be relevant where it is not possible to address all potential and actual adverse impacts immediately. Once the most significant impacts are identified and dealt with, the enterprise should move on to address less significant impacts.

**Practical actions for banks**

*First screen:* Identifying and assessing the most significant areas of RBC risk across client portfolios based on information provided by clients and independent research.

*Second screen:* Engaging in enhanced identification by consulting additional sources and engaging with clients to assess actual and potential impacts. This may also include identification based on a more narrow unit of analysis (i.e. on a high-risk project or asset triggered by identification of severe risks or actual severe impacts, known use of proceeds, or where a client has limited assets or operations).

Developing RBC monitoring lists to accelerate identification processes.

Developing a process for assessing the bank's involvement with an adverse impact, e.g. whether it may have contributed to the impact via its actions or omissions, and determining the appropriate response.

Ensuring that adequate early warning systems are in place to identify RBC risks outside of the screening process and periodic review.

***What are appropriate approaches to identify and assess actual and potential adverse impacts with respect to corporate lending and securities underwriting transactions?***

Identification of potential and actual adverse impacts is an ongoing, iterative process. Commonly, banks adopt a two-tiered process (first and second screen) for the identification and assessment of actual and potential adverse RBC impacts, alongside monitoring issues and complaints that may arise outside of this process.

***First screen***

This initial screening will be broad and identify high-level risks of adverse impacts related to sectors, geography or enterprise-specific risk factors (e.g. known instances of misconduct related to a specific company) across a client portfolio. This may be different from current practices of some large commercial banks where such screening may only be undertaken for a limited number of sectors that are subject to particular policies. A bank that provides multiple products and services and maintains very large portfolios of clients in different markets can take a risk-based approach to identification and concentrate initial efforts on where the risk of adverse RBC impacts are assessed to be the most significant.<sup>24</sup>

However, this should be based on an assessment of risk associated with the client sectors (e.g. products services and other activities), geographies (e.g. governance and rule-of-law, conflict, pervasive human rights or environmental adverse impacts) or client specific risk

<sup>24</sup> See for example: OHCHR, Response to request from BankTrack for advice regarding the application of the UN Guiding Principles on Business and Human Rights in the context of the banking sector, page 4 – “where possible a bank would be expected to first develop an understanding of its overall risk picture, including areas which (e.g. activities/sectors/relationships/clients, countries) are likely to pose the most severe risk, and them to prioritize those areas for more detailed analysis”.

factors (e.g. known instances of corruption, misconduct, poor implementation of standards for RBC).

Banks often base their assessment on information provided by their clients. Banks may also complement the information with their own research to enhance the quality of identification. Consulting additional sources such as market research services, reports from national authorities, international organisations, NGOs, other civil society organisations, independent experts, academia and media can be useful to supplement information provided by clients and provide more robust indications of risk areas. Where a bank is acting on information provided by clients or other third parties, it should assess the quality of the information provided. For example, if publically available information contradicts information provided by the client it may be useful to look further into the reasons for the discrepancy.

Additionally, banks can also prepare risk-based RBC monitoring lists of companies based on information already available or gathered about RBC risks associated with certain companies. Such lists can help to accelerate the due diligence process, as they can build on pre-assessments of the company, its sector or jurisdiction. Such lists may need to be revisited and modified periodically or in reaction to specific events.

### *Second screen (Enhanced identification)*

Based on the risk identified through the “first screen”, banks should prioritize clients whose operations entail the most significant risk for more detailed assessment, which may also sometimes involve assessing risks on a project or asset specific basis. (See Measure 2: Identify and assess actual and potential adverse impacts).

Enhanced identification processes can entail, as appropriate:

- Engaging with the client by asking them to clarify certain issues, provide additional documentation, and investigate certain instances.
- Conducting in-depth reviews of client’s operations based on documents provided by clients including, as relevant, existing Environmental and Social Risk and Impact Assessment, Human Rights Risk and Impact Assessment, as well as reports and assessments from independent third parties.
- Gathering information from additional sources including independent research providers, civil society organisations – such as NGOs, potentially affected groups, and other relevant stakeholders (noting that legal restraints relating to client confidentiality may need to be taken into account when consulting third parties regarding specific clients. (See Box 1.1).
- Assessing the likelihood that the provision of finance will be connected to activities that cause, contribute or are linked to adverse RBC impacts.

Enhanced identification in practice often involves the bank’s Environmental and Social Risk (“ESR”) unit. After conducting its own research, the ESR unit will reach out (as necessary) to the relationship manager, the compliance officer, or to the deal team to further investigate the situation. Banks may also seek to appoint specialists to support them in enhanced identification or expand internal ESR teams as necessary.

Certain banks have also sought to integrate this responsibility within deal teams. A RBC risk profile of the client and or transaction will be established through compiling the

findings and conclusions, and by putting forward, where relevant, recommendations on how to address identified RBC issues.

### *What is the scope of identification and assessment?*

General purpose loans and securities underwriting transactions usually take place at the corporate level, i.e. the bank provides finance or underwriting services which support the general operations or the expansion of a company, not to a specific project or asset (such as a power plant or an infrastructure project). Therefore, the primary unit of analysis for undertaking due diligence for corporate loans and securities underwriting in the first instance is usually the corporate entity (i.e. the entire client company), as opposed to a project or asset. Examples of information banks can look at during the identification process include:

- The client's corporate structure (e.g. subsidiaries, joint ventures) and strategy (e.g. expansion plans) and how this may impact RBC issues;
- The geographies in which the client is active and, if possible, those in which it will be active (e.g. sensitivity of the surrounding area and/or the likelihood that regulation pertaining to RBC issues is reliably enforced by governmental authorities).
- The industry sector in which the client is active (e.g. the likelihood that a specific industry sector causes, contributes to or is linked to adverse RBC impacts).
- The client's RBC policy and governance structure, including the clients' RBC polic(ies) and management systems;
- The client's RBC track-record and their ability and willingness to address RBC issues appropriately including with respect to clients due diligence over their own suppliers (e.g. controversies related to the company discussed in the media or raised by civil society);
- If relevant, the client's high-risk joint venture partners in subsidiaries.

In some limited instances, where enhanced (“second screen”) identification has been deemed to be appropriate, due diligence may also involve examining in detail the actual or potential adverse impacts associated with a specific asset or project. These may be appropriate in the following situations:

- Severe risks: where a bank identifies potentially severe adverse RBC impacts related to a specific asset, subsidiaries, or projects, based on geographic, sectoral, or company risk profile, a more detailed project level assessment for that specific asset or project may be triggered. For example, this may include identified risks of adverse impacts on indigenous peoples, critical habitats, significant cultural heritage, or large-scale resettlement at a significant asset of a client that is currently under development or proposed.
- Actual impacts: where a bank determines that actual severe impacts (such as serious human rights abuses) are present in respect of a specific asset.
- Use of proceeds: by definition, general corporate purpose finance has an unspecified use of proceeds, however in some circumstances a client may indicate how proceeds will be used, or information undertaken at corporate level may show

that proceeds will be used to fund primarily specific assets or projects (such as in the case of a single-asset company).

- Limited assets or operations: where the corporate entity only has a small number of projects or operations or where one asset or project represents a dominant proportion of production or revenues.

### *At what stage should banks identify and assess actual and potential adverse impacts of corporate clients?*

The client on-boarding process is often the ideal moment for the bank to identify actual or potential adverse RBC impacts that the company may be causing or contributing to. It may be easier for the bank to identify and act upon risks before committing to a client relationship.

As due diligence is an ongoing process, banks should find ways to ensure that they become aware of new actual or potential RBC issues related to their lending portfolios. In this respect, banks may find it helpful to define the frequency and extent of its periodic reviews of existing client's activities. Banks can also rely on third party services providing alerts on significant controversies against companies.

Putting effective early warning systems in place will help the bank identify RBC risks outside of the screening process and periodic reviews. Such early warning mechanism can include establishing and/or participating in grievance mechanisms, such as OECD National Contact Points (NCPs) and communication channels through which affected rightsholders and their representatives and others can raise concerns. Such mechanisms would not be specific to individual clients or operations but generally be established at the level of a bank's offices or headquarters or in collaboration with other actors. (See Measure 6: Provide for or cooperate in remediation when appropriate). Obtaining the client's consent for disclosing their business relationship with the bank would enable stakeholders to raise any concerns regarding client activities through such a mechanism.

### *How to address challenges while gathering information?*

Banks may face challenges in collecting comprehensive and credible information regarding actual and potential impacts associated with their clients. This can be due to practical limitations, such as time constraints or challenges accessing information due to lack of transparency of clients, different methodological approaches applied by data and research providers, and the fact that news, campaigns, and reports addressing RBC issues often focus on large and/or listed companies. Furthermore, certain circumstances may limit a bank's ability engage in enhanced risk identification, for example, when closer engagement and/or assessment may create market signals which may harm the company, pose issues under client confidentiality obligations, or when the prospective client does not cooperate in providing information.

Where information deficits exist, banks are encouraged to embrace complementary approaches, i.e. to combine quantitative and qualitative means, such as checklists, assessment tools, algorithm-based tools, indexes, reports, and regular consultation with clients and stakeholders in order to identify actual and potential RBC risks linked to specific companies or to industry sectors as a whole.

Furthermore, banks are encouraged to request additional information from clients as necessary. For example, private companies may not disclose a list of their assets unless the bank specifically requests them. Although often such lists may not be required for

credit/compliance checks, they may be requested by banks to facilitate risk identification. The leverage the bank has in the client relationship will influence the bank's ability to raise questions and request further information. For example, in business areas where clients receive access to substantial funds (relative to the market capitalisation of client) or in securities underwriting transactions in which a bank will raise a significant amount of capital for companies, the bank will generally have a greater level of engagement with the client. Therefore, it will be able to ask more questions and require additional documentation as necessary. Approaches to responding to leverage limitations are discussed further in Measure 3: Cease, prevent and mitigate adverse impacts.

The increasing rapidity of transactions can limit the time banks have to identify risks. To respond to this challenge, banks can source information from market research services which track certain aspects of RBC performance of companies or which catalogue ongoing campaigns against companies. Banks can also establish internal RBC monitoring lists which collect information related to RBC performance of companies.

Additionally, to address information deficits, banks can consider engaging in or initiating collaborative efforts, e.g. industry-wide and/or cross-sectorial initiatives, to obtain additional information from companies, and push for more and better disclosure on RBC risk. Many collaborative initiatives exist on a sectoral level to improve collection and monitoring of information related to real and potential adverse impacts.<sup>25</sup>

Although the above techniques can be helpful to responding to certain challenges, existing tools may still not be adequate to allow banks to adequately identify risks and impacts across their portfolios under the time constraints inherent in certain transactions. In this respect, banks can also be active in raising the need for development of better tools and processes to respond to this challenge.

Where client confidentiality issues are a concern, it may be possible to engage with stakeholders, such as impacted stakeholders or civil society organisations to better understand risks without mentioning a specific company or transaction. This may be the case where RBC issues are linked to risk factors that are not company-specific, but are rather of a sectoral, geographic, or product-specific nature, and where such engagement would not reveal the identity of the (prospective) client. Additionally, requesting client consent to disclose the relationship with the bank, for example as part of an on-boarding processes would enable the bank to reveal its business relationship with a client without breaching the client's confidence. (See Box 1.1).

### ***What role can stakeholders play in the identification and assessment of adverse RBC impacts?***

In the context of identification and assessment of RBC impacts a bank may:

- Engage with expert stakeholders to better understand and assess risks in a particular sector.

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<sup>25</sup> See for example for the extractives sector: Responsible Minerals Initiative, <http://www.responsiblemineralsinitiative.org/> Responsible Mining Index <https://responsibleminingindex.org/>; garment sector: the Fair Factories Clearing House, <https://www.fairfactories.org/>, Social & Labour Convergence Project (SLCP) <https://slconvergence.org/>; agriculture sector: Fair Food programme, <https://www.fairfoodprogram.org/>, Trase Earth <https://trase.earth/>.



- Engage with contractual stakeholders (i.e. employees, clients and shareholders) and well as regulators and expert stakeholders (e.g. global unions, NGOs) when developing a rationale for prioritisation.
- Encourage clients to undertake engagement with actually or potentially impacted stakeholders to contribute to the identification and assessment of impacts. In this context, it is important that a bank considers the quality of engagement rather than treating it as a tick-the-box exercise. (See *Characteristics of due diligence*).

Banks can also establish mechanisms through which stakeholders including rightsholders and other experts can raise potential issues related to a client's activities and provide feedback (e.g. early warning mechanism such as grievance mechanisms or hotlines, etc.). (See above and Measure 6: Provide for or cooperate in remediation when appropriate).

### **Box 2.2. The role of banks when several institutions are involved**

In transactions involving several banks, such as in a syndicated loan or a securities underwriting transaction, banks have different roles. This leads to a situation in which all participants may not have the same amount of information and time to assess RBC risks. Banks leading the transaction (often referred as lead arranger or lead manager) will normally have more time and better access to information while the transaction is being organised than banks which have a smaller role in the transaction. Agent banks will usually have more opportunities to interface with a client once financing has been provided. When a syndicate has agents and leading banks with robust due diligence, the participants will benefit from smoother due diligence, as relevant RBC documentation is likely to be prepared and available.

Banks can integrate RBC considerations in decision-making processes related to the participation in transaction with other banks (e.g. syndicated loans or securities underwriting transactions).

During the transaction, the agent bank may periodically review the client and whether or not it meets any stipulated conditions with respect to RBC. The agent bank may also take the lead in addressing actual or potential adverse RBC impacts they identify. In these instances the agent bank may inform the other members of the syndicate of such incidents and the steps the agent bank is proposing to address them, pending the approval of the syndicate banks as per the provisions contained in the financing documentation.

Banks in a syndicated transaction may also wish to collaborate on respect to due diligence. For example, they can collaborate in communicating the same expectations on RBC to client's accordance with relevant international RBC frameworks (e.g. MNE Guidelines). They can also collaborate in putting in place mechanisms to identify risk and actions which seek to cease, prevent and mitigate adverse RBC impacts.

For example, should any member of the syndicate become aware of RBC issues, it should inform the agent bank or other members so that they can be investigated..

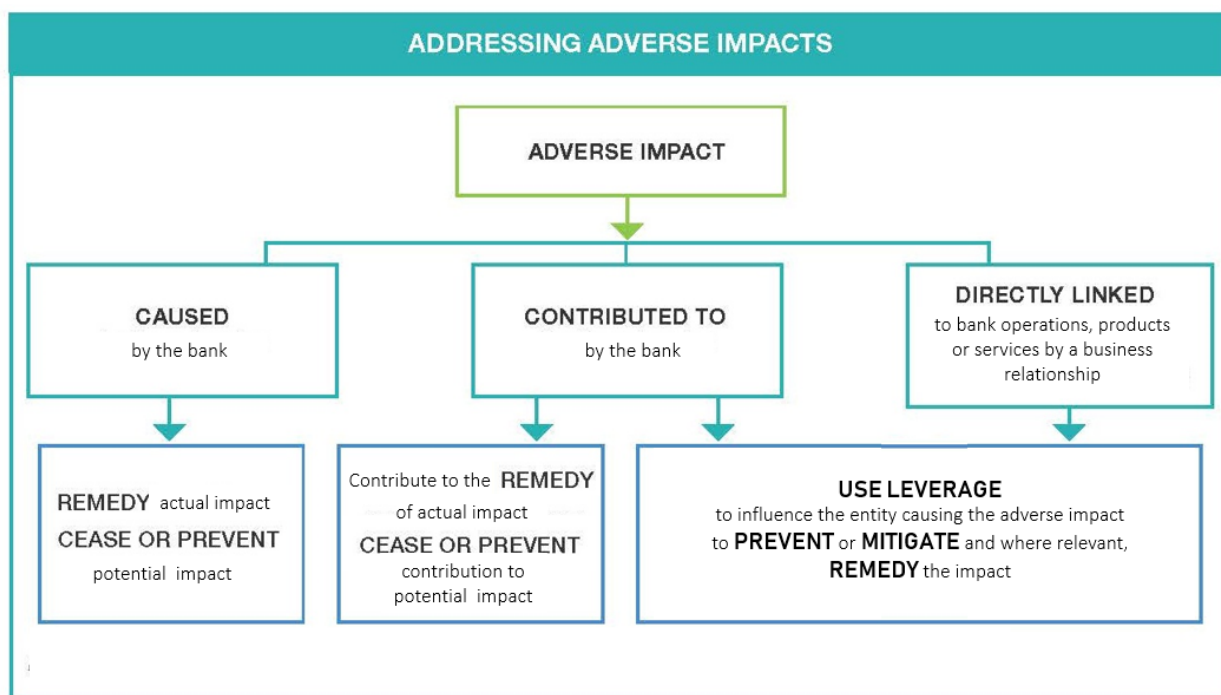
Cooperation on due diligence amongst banks in a syndicated transaction will necessitate a certain level of transparency amongst the banks. Competition law issues should be taken into account with respect to collaborative activities and obtaining client consent may be necessary to share the information amongst banks in syndicated transactions.

### 2.1.2. How can a bank assess its involvement with an adverse impact?

A bank may be involved with adverse impacts in three different ways: (a) the bank causes adverse impacts itself; (b) it contributes to adverse impacts caused by another entity or in combination with the activities of other entities or (c) adverse impacts are directly linked to the bank’s services by a business relationship.

It is important to assess involvement with an adverse impact as it will inform how a bank should address it. See Figure 2.1 below.

Figure 2.1. Type the title here



The issue of a bank causing adverse impacts is beyond the scope of this analysis as this paper focuses on adverse impacts associated with a bank’s clients – or the client’s subsidiary – and not solely by the bank itself (see Section on Scope).

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. Assessment of whether a bank is contributing to an actual or potential adverse caused by a client is a complex exercise. Where an adverse impact has occurred, this assessment is relevant to considering whether a bank should play a role in providing for or cooperating in remedy for adverse impacts caused by a client that have materialised – or not. If a bank is not considered to be contributing to an impact, its response to that impact can be more limited to using its leverage with the client because it is only considered directly linked.

Where a bank is contributing to an adverse impact, it is expected to provide for or cooperate in its remediation. In this regard, remedy can take a variety of forms. What is appropriate

will depend on the nature and extent of the impact. (See Measure 6: Provide for or cooperate in remediation when appropriate).

General guidance on this issue from the OECD Due Diligence Guidance on this issue is reproduced in Box 2.3. A discussion of its application in the context of general corporate lending and underwriting transactions is below.

**Box 2.3. Excerpt from OECD Due Diligence Guidance for Responsible Business Conduct on relationship to Impact (page 70)**

**Contribute:** An enterprise “contributes to” an impact if its activities, in combination with the activities of other entities cause the impact, or if the activities of the enterprise cause, facilitate or incentivise another entity to cause an adverse impact. Contribution must be substantial, meaning that it does not include minor or trivial contributions.

The substantial nature of the contribution and understanding when the actions of the enterprise may have caused, facilitated or incentivised another entity to cause an adverse impact may involve the consideration of multiple factors. The following factors can be taken into account:

- The extent to which an enterprise may encourage or motivate an adverse impact by another entity, i.e. the degree to which the activity increased the risk of the impact occurring.
- The extent to which an enterprise could or should have known about the adverse impact or potential for adverse impact, i.e. the degree of foreseeability.
- The degree to which any of enterprise’s activities actually mitigated the adverse impact or decreased the risk of the impact occurring.

The mere existence of a business relationship or activities which create the general conditions in which it is possible for adverse impacts to occur does not necessarily represent a relationship of contribution. The activity in question should substantially increase the risk of adverse impact.

**For example,** consider a retailer that sets a very short lead time for delivery of product despite knowing from similar products in the past that the production time is not feasible, and restricting the use of pre-approved sub-contracting.

- The action of setting a shorter than feasible lead time and restricting the use of sub-contracting increased the risk of excessive overtime at the level of the manufacturer.
- The degree of foreseeability of the impact may be high because the retailer knew that lead times for similar past products were not feasible and that short lead times commonly result in excessive overtime in the sector.
- If no mitigating steps were taken to decrease the risk of the impact occurring, the retailer may be contributing to excessive overtime at the level of the manufacturer.

**For example,** consider a private equity investor which invests in a steel plant. The investor sits on the board of the steel plant and regularly interacts with its management. The investor votes against installing costly equipment which treats run-off from the plant.

As a result of the lack of run-off treatment, the drinking water of a local community is polluted by the run-off.

- Encouraging management of the project to avoid installing technology which may prevent or mitigate environmental impacts on water sources increases the risk of adverse impacts.
- The degree of foreseeability may be high if it is commonly known among environmental management professionals in the steel industry that water treatment equipment is required to avoid pollution of drinking water.
- If the investor undertook due diligence and supported an alternative treatment plan for the run off, the risk of pollution of the water supply and the foreseeability of that impact would have been lower, moving the investor away from a relationship of contribution.

[...] An enterprise's relationship to adverse impact is not static. It may change, for example as situations evolve and depending upon the degree to which due diligence and steps taken to address identified risks and impacts decrease the risk of the impacts occurring.

Where an impact has occurred, a determination of whether a bank substantially contributed to that impact (i.e. not a minor or trivial contribution) can be based on an analysis of the below highly interrelated factors:

- The degree to which the bank's activities increased the risk of the impact occurring by *facilitating* or *incentivising* a client to cause an adverse impact;
- The degree of foreseeability of the impact;
- The degree to which actions taken by the bank actually mitigated or decreased the risk of that impact.

For a bank to incentivize an adverse impact through a corporate lending or securities underwriting transaction, in addition to the provision of the lending or underwriting service, the bank needs to have taken a specific action or omission that motivated or encouraged a client to cause harm (See example A in Box 6).<sup>26</sup> It has been challenging to identify examples in practice where a bank has taken actions to incentivise its client to cause harm in the context of a general corporate lending and securities underwriting transaction.

For a bank to facilitate an adverse impact through a corporate lending or securities underwriting transaction, in addition to the provision of the service itself, there would have to be some action or omission by the bank that enabled or made easier for a client to cause harm. In this regard, "providing a financial product or service, is not inherently problematic — it is in fact an important service to commerce."<sup>27</sup>

For example, taking into consideration all the interrelated factors above, a bank may have contributed to an adverse impact by facilitating where all of the following elements occur together:

- The adverse impact caused or contributed to by a client's activities or projects was foreseeable;

<sup>26</sup> See also OHCHR response to request from BankTrack for advice regarding the application of the UN Guiding Principles on Business and Human Rights in the context of the banking sector (2017) <https://www.ohchr.org/Documents/Issues/Business/InterpretationGuidingPrinciples.pdf>

<sup>27</sup> Ibid.

- The use of proceeds was known (or likely) to be for those client’s high-risk activities or projects (see example B in Box 6)); or almost all the client’s activities were high risk of causing or contributing to the type of adverse impact being considered<sup>28</sup> (See example C in Box 6); *and*
- The provision of the finance or underwriting service occurred without adequate due diligence (see paragraphs below). In this respect, the due diligence processes the bank had in place, and how they were implemented should be considered.

Importantly, in considering the adequacy of due diligence, this paper should provide a reference on good practice for banks. The quality of a bank’s systems and its due diligence processes can influence whether a bank contributes to adverse impacts. With regards to human rights impacts, for example, the OHCHR has explained that, “[c]arrying out due diligence appropriate to the scope and complexity of a bank’s portfolio and risk picture should help it effectively identify risks and prevent them from occurring.”<sup>29</sup>

Due diligence can involve risk-based prioritisation. As has been discussed in the section on *Characteristics of Due Diligence*, where it is not possible to address all actual or potential adverse impacts identified, banks can prioritise risks based on their severity and likelihood (relative to other risks in their portfolios).

In these cases, banks should be prepared to communicate their reasons for prioritising those risks before others (see Measure 1: Embed RBC into policies and management systems and Measure 5: Communicate how impacts are addressed). If a bank takes no action to prevent or mitigate adverse impacts associated with clients, its prioritisation criteria and the other characteristics of due diligence will be particularly important when considering the adequacy of due diligence (See example C in Box 2.4). The decision to provide additional finance to a client where an adverse impact caused by the client continues or reoccurs will also be relevant in assessing the adequacy of the bank’s due diligence.

Additionally, due diligence measures can be adapted to deal with the limitations of working with business relationships, for example when banks face practical and legal limitations to how they can influence or affect their clients. A bank can seek to prevent impacts through a broad range of measures that can include, for example, collaborative efforts to pool leverage, including engaging in initiatives to target systemic issues, improving the bank’s due diligence processes, as well as engagement with specific high-risk clients. (See Measure 3: Cease, prevent and mitigate adverse impacts, Practical actions).

#### **Box 2.4. Hypothetical examples on contribution in general corporate lending transactions**

**Example A:** A bank advises its client, a commercial manufacturer of chemicals, to cut costs with respect to its future operating expenditures as a condition of a financing agreement. As a result, the client does not invest in upgrading technologies to treat run off from some of its chemical production plants and the water supply of one local community is contaminated. In such a situation, the bank may have motivated or encouraged the client to take an action which led to an adverse impact, and therefore may have incentivised the

<sup>28</sup> For adverse impacts that are collective, diffuse and transboundary in nature such as climate change, a more nuanced analysis may be needed to understand the relationship between financing and the specific activities of the client causing harm.

<sup>29</sup> OHCHR (2017)

adverse impact. The degree of foreseeability of the impact and degree to which actions taken by the bank actually mitigated or decreased the risk of that impact would also be relevant to consider. While demonstrative, in practice, such a situation would not normally arise in the context of corporate lending transactions, as banks generally do not provide advisory services in the context of these transactions or condition the provision of lending on cost-cutting measures.

**Example B:** A bank is engaging with a potential client, a private security company which is widely reported to be perpetuating serious human rights abuses in the context of several of its largest operations which are situated in conflict-affected areas. The bank extends the financing without making appropriate attempts to use its leverage to influence the client to prevent or mitigate human rights violations associated with its operations. In this example, the impacts were foreseeable and should have been prioritised on the basis of likelihood and severity of the impact. The bank extended the financing without making due efforts to prevent or mitigate the harm. This, coupled with the bank's decision to extend the financing (with proceeds likely used to support the client's high-risk activities), and failure to carry out adequate due diligence, may have made it easier for the client to perpetrate human rights abuses, and therefore may have facilitated the adverse impacts. However if the bank sought to prevent or mitigate the impacts by requiring the client to demonstrate that adequate safeguards were being implemented by the client to prevent future abuses, the bank could demonstrate it made reasonable efforts to prevent or mitigate the adverse impacts.

**Example C:** A bank provides general corporate financing to a client for which the use of proceeds is known – an infrastructure project associated with potential social and environmental impacts. The client undertakes and provides to the bank an environmental and social impact assessment (ESIA) which does not conform to industry standards and does not accurately estimate the scale of impacts associated with the project. If the bank proceeds with provision of the financing without requiring a credible environmental and social impact assessment as a condition of financing, and an adverse impact occurs because it wasn't sufficiently identified in the ESIA, the bank may have facilitated the impact. However, if the bank can demonstrate its decision not to prioritise the client for more detailed due diligence was based on a valid assessment of the likelihood and severity of risk, it may demonstrate that its level of due diligence was adequate. However, such an occurrence should trigger a bank to reassess its prioritisation decisions with respect to the client in future transactions. In addition, the bank should use whatever leverage it has over the client to seek to prevent and mitigate the impact, including by seeking to ensure that the client remediates the impact. If the bank continues to maintain a business relationship with the client (e.g. by providing new financing) in the absence of the impact being remediated, then the bank may be considered to be facilitating an ongoing (unremediated) impact due to inadequate due diligence.

**Note:** While technically a general corporate loan some banks may classify this as a project finance transaction and for signatories to the Equator Principles (EPs) such a transaction may trigger an enhanced due diligence process as outlined under the EPs.

A bank may assess its relationship to impacts through its own due diligence processes, in consultation with stakeholders, or, where appropriate, through an operational-level

grievance mechanism.<sup>30</sup> (See Measure 6: Provide for or cooperate in remediation when appropriate).

### Measure 3: Cease, prevent and mitigate adverse impacts

3.1. Stop activities that are causing or contributing to adverse impacts on RBC issues, based on the enterprise's assessment of its involvement with adverse impacts as per 2.3 above. Develop and implement plans that are fit-for-purpose to prevent and mitigate potential (future) adverse impacts;

3.2. Based on the enterprise's prioritisation in 2.4 above, develop and implement plans to seek to prevent or mitigate actual or potential adverse impacts on RBC issues which are directly linked to the enterprise's operations, products or services by business relationships. The plan should detail what actions the enterprise will take, as well as its expectations of its suppliers, buyers and other business relationships. Appropriate responses to risks associated with business relationships may include, at times:

- (a) continuation of the relationship throughout the course of risk mitigation efforts;
- (b) temporary suspension of the relationship while pursuing ongoing risk mitigation; or,
- (c) disengagement with the business relationship either after failed attempts at mitigation, or where the enterprise deems mitigation not feasible, or because of the severity of the adverse impact. A decision to disengage should take into account potential social and economic adverse impacts.

#### Practical actions for banks

General approaches to prevention may include:

- Drawing from the findings of risk identification to strengthen management systems to better track information and flag risks, including those associated with specific clients, geographies, products or sectors, before adverse impacts occur.
- Building up sectoral expertise that includes understanding what preventive measures can be put in place and working with clients on implementing those.
- Defining exclusionary criteria that prohibit the provision of a financial service to companies under specific circumstances or for specific clients.
- Defining conditions for the provision of financial services to companies based on their adherence to well-established and recognized standards and/or good practice related to RBC issues.
- Providing training that is fit-for purpose for the bank's relevant staff and management.
- Assigning relevant senior responsibility to oversee implementation of preventive measures.
- Seeking to influence a client to develop stronger RBC risk management systems.

For corporate lending activities:

<sup>30</sup> Ibid.

- Incorporating RBC expectations into contractual documents or other written statements/commitments with prospective clients. For example, requiring clients to put RBC management systems in place or meet specified international standards or conditioning disbursements on a verification of specified environmental and social conditions.
- Requesting client consent for waivers of confidentiality of the client's relationship to the bank where relevant.
- Providing prospective clients with incentives to meet certain RBC related targets (e.g. coupling the interest rate of the loan with the company's sustainability performance).

For underwriting securities activities:

- Where relevant requiring a deep level of due diligence e.g. an environmental impact assessment and encouraging the client to report on RBC risks in investor information disclosures (prospectus).

Appropriate responses once actual or potential adverse impacts have been identified may include:

- Assigning responsibility for ensuring that bank activities that cause or contribute to adverse impacts cease.
- Encouraging clients to create a roadmap for how the client can cease the activities that are causing or contributing to adverse impacts, involving impacted or potentially impacted rightsholders and other stakeholders as relevant. If need be, banks can recommend the client to hire an external environmental and social consultant to support mitigation activities.
- Engaging with prospective and existing clients through face-to-face meetings with its representatives from operations, senior management, and/or board level to discuss on how their clients are approaching the key RBC matters relevant to their business and to request time-bound action to address or mitigate a particular impact.
- Collaborating with other banks involved in the transaction or other stakeholders to exert leverage on RBC matters, subject to legal obligations.
- Connecting clients with needed resources to address impacts and manage risks.
- Terminating or suspending the provision of financial services, in accordance with contract clauses, or raising the credible prospect of doing so. (See Measure 3: [Cease, prevent and mitigate adverse impacts](#)).
- Considering not engaging in future business opportunities with the client (as an additional measure or as an alternative to terminating the client relationship when an immediate termination is not possible or would cause severe adverse impacts to impacted stakeholders).

For underwriting securities:

- Advising clients to include RBC issues in disclosure documents (e.g. the prospectus or brochure in a securities underwriting transaction) and requesting the client to explain how it is planning to address the key RBC issues that are likely to affect its future performance.
- Challenging a client's perception of material risk issues (with RBC risks often being seen as not financially material, or not relevant to investors).

Appropriate responses for addressing systemic issues may include:



- Joining geographic or issue-specific initiatives that seek to prevent and mitigate adverse impacts in the areas identified (e.g. country, commodity, or sector roundtables or multi-stakeholder initiatives), which may also include engagement with governments.

### ***How should a bank respond to actual or potential impacts?***

In cases where a bank is contributing to adverse impacts or risks that are caused by its client, it should take necessary steps to cease or prevent its own contribution, provide for or cooperate in remediation of the impact through legitimate processes, and use its leverage to seek to prevent and mitigate any remaining impacts (see Measure 2: Identify and assess actual and potential adverse impacts).

Where the adverse impacts are directly linked to a bank's lending or securities underwriting through a client, it should also use its leverage to seek to prevent and mitigate those impacts. This is not intended to shift responsibility from the client who is causing or contributing an adverse impact to the bank.<sup>31</sup> The responsibility for ceasing, mitigating and remedying the impact remains with the client who is causing or contributing to the impacts.<sup>32</sup>

However, while the bank may not be able to address the impact itself, it should seek to influence its client to prevent or mitigate and remediate the adverse impacts.<sup>33</sup> Impacts caused by a client may also pose reputational risks for banks. Various potential approaches for responding to impacts are included in the practical actions above.

### ***How can contractual agreements be used to help cease, prevent or mitigate adverse impacts associated with client relationships?***

To some extent, contractual agreements and other written documents often already address RBC provisions via general clauses, such as clauses requiring the client to comply with all applicable laws and regulations, including rules and regulations that intend to prevent money laundering or the financing of terrorism. However, due to the lack of laws specifically addressing a client's performance on human rights and environmental issues in the context of banking transactions, the inclusion of such RBC issues into contractual agreements for general corporate lending transactions is not common.

Banks can go beyond legal minimum requirements when drafting contract clauses. Including a clear articulation of the bank's RBC policies and expectations of clients in contractual agreements may facilitate the engagement with the client in relation to RBC issues and help the bank increase and use leverage to address any impacts that may arise. (See Measure 3: Cease, prevent and mitigate adverse impacts). The bank's legal counsel (either internal or external) responsible for developing the contract would benefit from having a strong awareness of RBC issues and how they should be integrated into the agreement. Promotion of RBC clauses by recognized initiatives such as the Loan Market Association, would be useful to overcoming potential difficulties to including such language in contractual agreements. Banks may also articulate its RBC expectations, in particular those related to environmental and human rights issues, in other written

<sup>31</sup> OECD Guidelines, Chapter II, paragraph 12.

<sup>32</sup> Ibid.

<sup>33</sup> OECD Due Diligence Guidance, Section I, Characteristics of Due Diligence – Due diligence does not shift responsibilities.

documents. In both cases it is important that the bank monitors that clients comply with such provisions.

### *How can a bank overcome leverage limitations?*

Where an RBC risk is identified, a bank's ability to exercise influence over the company concerned – to use its leverage to mitigate the RBC risk – may be affected by a number of factors. For example:

- The nature of the transaction and the duration of the relationship between a bank and a company.
- The nature of the relationship and point in time of a particular transaction e.g. whether it is a client relationship or a prospective client relationship.
- The competitive situation in the market, e.g. how easy it is for the company to access financing with comparable conditions from other sources.
- The role the bank has in the transaction, whether it is a leading bank or a member of a larger syndicate.
- The reputation and “attractiveness” of the bank for the client.
- The time and capacity available for the bank to actually exercise leverage.

The MNE Guidelines recognise that “there are practical limitations on the ability of enterprises to effect change in the behaviour of their suppliers.”<sup>34</sup> Likewise, banks may face practical limitations in effecting change amongst their clients. The degree of leverage a bank has over the client causing an adverse impact is useful in considering what it can do to persuade that entity to take action. However, it is not relevant to considering whether the bank should carry out due diligence and effectively exercise any leverage it may have, or seek to build additional leverage.<sup>35</sup> Under the MNE Guidelines, banks have a responsibility to exercise their leverage to prevent or mitigate adverse impacts even when they may not have much of it. Leverage can be employed in a number of ways, and efforts can be made to increase leverage where a bank does not have enough.

For example:

- A bank's ability to exercise leverage is generally higher before the actual provision of a financial service. Therefore, banks can work to build leverage by including RBC expectations into contractual agreements and other written documents as a condition of receiving financing or specific disbursements, particularly for high-risk clients. Once the transaction has been concluded, a bank's leverage may be significantly reduced. In these situations banks may seek to engage directly with clients to communicate concerns, relying on expectations around RBC already communicated to clients or included in commitments. In certain circumstances they may also consider disengagement from the client if possible based on contracting terms or communicating to the client that failure to prevent and mitigate impacts

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<sup>34</sup> See OECD Guidelines for Multinational Enterprises (2011), Chapter II, Commentary, paragraph 21.

<sup>35</sup> Ibid., see also Commentary, paragraph 20 and OECD (2014) Due diligence in the financial sector: adverse impacts directly linked to financial sector operations, products or services by a business relationship, <https://mneguidelines.oecd.org/rbc-financial-sector.htm>

may prevent them from accessing financing or securities underwriting services from the bank in the future. (See Measure 3: Cease, prevent and mitigate adverse impacts).

- Capital market transactions, such as debt or equity capital market transactions, do not provide long-term opportunities to maintain some degree of leverage over a client. For this reason, risks need to be identified upfront and potential mitigation actions agreed to before an underwriting transaction is launched. For example, where a risk is identified, further assessment and development of recommendations may be needed; the client can commit to implementation of the recommendations and disclosing RBC issues in the IPO Prospectus or brochures as relevant.
- In situations where a client with a general corporate loan has separate asset-specific financing for an asset that is associated with adverse impacts, the bank's access to information and leverage with respect to the separately-financed asset will be limited if it is not a participant in the asset specific financing. However, the bank could still seek to use its leverage with the client to address any severe adverse impacts, including those that are separately financed.
- In case of long-standing and stable relationships a bank's leverage towards the client persists and increases the ability of the bank to address challenging issues with the client whereas it may be more challenging to do so for new clients. In these cases banks may consider providing incentives to new clients to meet RBC targets. For example, some banks have offered favourable financing terms linked to RBC conditions to prospective clients. However, currently, such types of arrangements, often referred to as positive impact loans, are not very common and are often based on a limited set of auditable KPIs.
- A non-leading bank in a syndicate may have limited leverage over a client independently; however, they can seek to collaborate with other banks in a syndicated transaction to increase leverage (See Box 2 and Box 4).
- A bank's leverage may be curtailed by competition and market conditions, which, in many instances, remain favourable to clients. In this respect banks can work together to set an example and establish common industry practice to promote systematic engagement with clients on RBC. Banks can also communicate the benefits of due diligence to clients to encourage their participation in the process and promote RBC through incentives.

In situations where banks lack leverage with respect to specific transactions or clients, they can individually and collectively engage with regulators, policymakers and civil society organisations to promote prevention and mitigation of certain risks more broadly.

### *When should a bank disengage from a client?*

Disengagement may be an appropriate response to identified adverse impacts where attempts at prevention or mitigation have been unsuccessful after an escalating period of engagement; where mitigation is unfeasible; where there is no reasonable prospect of change; or where severe risks are identified and the entity causing the impact does not take immediate action to address these.<sup>36</sup> Because banks cannot unilaterally stop disbursements

<sup>36</sup> OECD Guidelines for Multinational Enterprises, Chapter II, Paragraph 22.

or request an early prepayment of a loan unless this is expressly provided for in the financing documentation, disengagement in certain circumstances may involve avoiding additional provision of services to clients in the future.

Importantly, the MNE Guidelines do not recommend categorical “de-risking”. Generally, rather than completely avoiding contexts that raise potential risks, banks are encouraged to engage with clients to ensure that these risks can be/are responded to effectively. Under the MNE Guidelines, disengagement will often be a last resort.<sup>37</sup> However, in some cases, it may be a first response to adverse impacts, if such impacts are very severe. In this respect, some banks have exclusion policies for highly damaging industries or products, or blacklists for companies with a history of irresponsible behaviour.

#### **Box 2.5. Considerations for Exclusionary Policies**

Exclusionary policies refer to the phenomenon of financial institutions terminating or restricting business relationships with clients or categories of clients which are deemed to be high-risk (in this case, high risk of adverse impacts on people, the environment or society).

There can be various drivers to a bank’s decision not to provide services to a particular sector, including: concerns about profitability; lack of specialist expertise in the sector; reputational risk; lower risk appetites of financial institutions; the costs related to the implementation of anti-money laundering and counter-terrorist financing laws; the increasing number of sanctions regimes; and increased capital requirements.

In some circumstances exclusion can be appropriate, for example where risks are very severe or irremediable. However, the potential impacts of exclusionary practices should also be taken into account when making such a decision. For example, exclusion can limit access to the global financial system for companies operating in high-risk sectors, including companies applying adequate due diligence. This may increase financial exclusion and lead to alternative, less regulated, forms of financing and reduce transparency, thereby increasing these companies’ exposure to a whole range of risks – including financial crime. Blanket bans may also miss opportunities for potentially raising standards in high-risk sectors. Banks are encouraged to engage with prospective or existing clients, and other relevant stakeholders related to high-risk contexts, in order to understand whether the client can address risks before deciding to exclude.

In the case of corporate lending transactions, a bank’s termination of an ongoing relationship with a client will in many cases only be possible in the event of a material breach of a contract. In some corporate lending transactions, banks may also be able to sell their stake on the secondary loan market, however in certain circumstances such a sale might require approval from the client. 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.

Some additional factors to consider when deciding if disengagement is an appropriate response are: the bank’s leverage over its client; the severity of the impact; and whether

<sup>37</sup> OECD Guidelines for Multinational Enterprises (2011), Commentary to General Policies, paragraph 22.

terminating the relationship with the client would result in adverse impacts; and how crucial a client relationship is to the bank.

Disengagement from a client may be facilitated by establishing a policy and process when a client does not meet its commitments or is unwilling to further engage on RBC issues. Such policy and process can envisage the following:

- Principles guiding the evaluation and assessment of the situation including criteria that trigger the assessment of potential termination or suspension in a relationship;
- Considerations when terminating a relationship, namely regarding the impact this might have, i.e. the priority being to avoid creating greater harm;
- Management and operational processes to be followed internally, such as escalation of the issue to a committee;
- Timelines to be observed when suspending or ending the relationship as well as for re-entry into a business relationship; and
- Criteria and principles informing the assessment of re-entry into a business relationship.

In some instances, termination may not be possible due to contractual clauses or the nature of the transaction. In this respect it is important banks consider circumstances under which they could terminate a relationship with a client that is causing adverse impacts at the stage when contractual terms are being established with the client.

Continuing a business relationship with a client which has been identified as causing or contributing to adverse impacts by way of providing additional financial product and services may also pose reputational risks or potential financial risks to the bank.<sup>38</sup> In cases where banks decide to continue a business relationship with a client that is causing or contributing to adverse impacts, they should report the situation internally as part of their efforts to track their due diligence processes. (See Measure 4: Track implementation and results). They should also continue to monitor the client, for example, through maintaining a knowledge database, and revisit their decision where circumstances change or as part of the bank's long term strategy to systemically respond to all of the recommendations of the MNE Guidelines. In these instances, and where legal obligations with respect to client confidentiality allow, it may be in the banks interest to publicly explain their decision to maintain the business relationship, how this decision aligns with their RBC policy and priorities, what actions are being taken to attempt to apply leverage to mitigate the impacts, and how the client will continue to be monitored in the future.

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<sup>38</sup> United Nations Guiding Principles, Guiding Principle 19, Commentary. "For as long as the adverse impact continues and the enterprise remains in the relationship, it should be able to demonstrate its own ongoing efforts to mitigate the impact and be prepared to accept any consequences – reputational, financial or legal – of continuing the connection."

## Measure 4: Track implementation and results

4.1. Track the implementation and effectiveness of the enterprise's due diligence activities, i.e. its measures to identify, prevent, mitigate and, where appropriate, support remediation of impacts, including with business relationships. In turn, use the lessons learned from tracking to improve these processes in the future.

Practical actions for banks	<p>Tracking clients' implementation of RBC commitments:</p> <ul style="list-style-type: none"> <li>• Requesting clients to report periodically on certain issues based on their RBC risk profile or to explain how they comply with their RBC commitments or policies and assessing these reports.</li> <li>• In certain high risk cases, requiring third party review of compliance with RBC policies and/or requirements for high-risk clients on behalf of the bank.</li> <li>• Building on existing processes such as annual credit reviews or KYC reviews to track RBC performance of clients.</li> </ul> <p>Tracking own performance against policies on RBC or other commitments the bank has made on RBC issues.</p> <p>Responding to findings to improve due diligence processes (e.g. integrating overlooked real or potential impacts in identification activities, modifying engagement strategies based on outcomes etc.).</p>
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### *How can a bank track client's implementation of RBC commitments?*

Tracking involves first and foremost assessing whether identified adverse impacts have been responded to effectively. Where clients are associated with impacts and prioritised for prevention and mitigation the bank should also track client responses to ensure that those impacts are addressed.<sup>39</sup>

For general corporate lending transactions, banks can request clients to report periodically on certain issues based on their RBC risk profile according to parameters and timeline previously set, or to explain how they comply with their RBC commitments or policies. It can also check client reports against own insights and third-party information, e.g. reports produced by independent third parties, such as specialised consultancies and rating agencies, civil society organisations or monitoring services provided by specialised data providers.

Additionally, for general corporate lending transactions banks can build on existing processes. These include annual credit reviews or KYC reviews which may also be conducted annually by compliance departments. For both processes, there may be an opportunity for tracking of RBC commitments of clients.

The duration of the bank's relationship with the client may impact tracking activities, since it may be difficult to collect information about a client once a business relationship is formally terminated. If the client is involved in recurring transactions with a bank, a bank

<sup>39</sup> See OECD (2018) Due Diligence Guidance for Responsible Business Conduct, Annex Q 4

can review a client's progress in developing their RBC commitments/ management systems over time.

Establishing appropriate qualitative and quantitative indicators can be helpful to tracking activities. Potential indicators to assess whether identified adverse impacts have been responded to effectively may include:

- Percentage/number of agreed action points that have been implemented by the client according to planned timelines.
- Percentage/number of issues raised by stakeholders and through grievance mechanisms that have been responded to by the client.
- Actual changes with regard to adverse impacts (e.g. changes in carbon emissions rates of clients over time).

### ***How can a bank track the implementation and effectiveness of its due diligence activities?***

A bank can track its own performance with respect to how it has responded to identified adverse impacts as well as the effectiveness of its due diligence process.

Potential indicators to measure due diligence performance may include:

- Percentage/number of clients in a portfolio assessed on RBC risks.
- Percentage/number of clients in a portfolio that have triggered enhanced identification which underwent enhanced identification.
- Percentage of clients associated with real or potential impacts with which the bank sought to apply leverage to prevent and /or mitigate, and rate of successful outcomes with respect to leverage activities.
- Rate of reoccurrence of identified adverse impacts based on a bank's RBC monitoring of clients in its portfolio.
- Where the bank itself has established, or participates in, grievance mechanisms, the number and type of issues raised through grievance mechanisms, and the effectiveness of its response (noting that increases in number of complaints is not necessarily an indicator of a higher number of impacts, but may be due to increased accessibility of the mechanism).
- Actual changes with regard to adverse impacts (see above).

Additionally, measuring changes in practices or behaviours that are more likely to result in better outcomes with respect to RBC risk management can also be useful. For example, tracking the means by which RBC risks are taken into account in financing decisions of deal teams through the number of times deal teams proactively request the ESR team's advice.

### ***How should banks respond to the results of tracking activities?***

Lessons learned should be reflected in the bank's due diligence processes in order to improve the process and outcomes in the future. For example, adverse impacts or risks that may have been overlooked in past due diligence processes and can be identified and included in future risk identification and mitigation processes.

Tracking provides the bank with an understanding of whether the systems it has put into place are effectively enabling the enterprise to avoid and address adverse impacts in its own activities and across its portfolio or whether systems could be modified to be made more effective. Where a bank's due diligence processes or approach are not effective, an internal assessment to understand why may be useful. Consulting staff involved in the due diligence processes and relevant external stakeholders in this process may be helpful.

Establishing senior oversight of tracking also helps to ensure that lessons learned are taken into account and due diligence systems can be continuously improved.

### Measure 5: Communicate how impacts are addressed

5.1. Communicate externally relevant information on due diligence policies, processes, activities conducted to identify and address actual or potential adverse impacts, including the findings and outcomes of those activities.

Practical actions for banks	<p>Publicly communicating on:</p> <ul style="list-style-type: none"> <li>– RBC policies, including a statement of policy that expresses the bank's commitment to respect human rights.</li> <li>– The implementation of policies including information on measures taken to embed RBC policies into management systems.</li> <li>– Areas of significant risks and the significant adverse impacts identified, prioritised and assessed, as well as the prioritisation criteria (at the level of client portfolios or business areas).</li> <li>– The number of cases subjected to enhanced due diligence.</li> <li>– Efforts to prevent and mitigate actual or potential adverse RBC impacts (at the level of client portfolios or business areas) or co-operation in remediation as relevant.</li> <li>– Future RBC plans and targets (at the level of client portfolios or business areas).</li> </ul> <p>Where a bank has contributed to human rights impacts, providing information sufficient to demonstrate the adequacy of the banks response to the specific human rights impact to the impacted rightsholders.</p>
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#### *How can a bank communicate publicly?*

Public disclosures should include the bank's RBC policies and information on measures taken to embed RBC into policies and management systems. They should also include the bank's general areas of significant risks as well as significant adverse impacts or risks identified, prioritised and assessed an explanation of the prioritisation criteria, and how these risks and impacts have been or are being addressed.

Banks may choose the format of public communication on due diligence, provided that the public can easily access the relevant information. Communication will often take the form of an annual report on sustainability or corporate responsibility available on the bank's



website. Public communication on due diligence may also be folded into other forms of disclosure. Some jurisdictions or stock exchanges may have specific reporting requirements with respect to RBC risks, issues or due diligence. Banks should ensure they respond to local reporting requirements and also seek to communicate on how impacts are addressed as described in this paper. This is likely to mean providing additional information beyond what is asked for under local regulations.

Additionally, in order to promote more standardized and comparable reporting, banks may also seek to communicate publicly in line with widely recognized reporting frameworks, such as those developed by the Global Reporting Initiative (GRI).<sup>40</sup>

In the context of securities underwriting, the bank may encourage the client to include an overview of the information listed in the practical actions section and above in the prospectus and marketing material for issuing shares and bonds.

Banks are encouraged to move towards promoting transparency. Public disclosures by banks on social and environmental impacts associated with their clients have been very limited in practice. Recently some banks have begun to issue enhanced disclosures including reporting on their most significant impacts and examples of how they have used leverage with specific clients to address them – having sought the clients’ permission to report this information.

### ***How can a bank communicate with impacted stakeholders?***

Banks should encourage their clients to engage with stakeholders directly. Where a bank has or may have contributed to adverse impacts it should be prepared to communicate with impacted or potentially impacted rightsholders.

In these cases, banks will often find it best to communicate in collaboration with the client in question. Such communications should occur in a timely, culturally sensitive and accessible manner. Accessibility of information means that it is not only physically accessible, but also understandable and disclosed at a time and in a format, language, and location that will best ensure that those for whom it is intended will notice it and be able to use it effectively. Such information may be communication through dialogue rather than in writing as appropriate. This information should be “sufficient to demonstrate the adequacy of an enterprise’s response to the particular human rights impact involved” and “in turn not pose risks to affected stakeholders, personnel or to legitimate requirements of commercial confidentiality.”<sup>41</sup> In this respect, banks may find it useful to engage local expertise and advice to support them in communicating with impacted rightsholders in an appropriate manner.

### ***How can client confidentiality concerns be addressed when communicating?***

Client confidentiality should not prohibit public communication on due diligence if a bank communicates information in an aggregated or anonymized way. Even when aggregating or anonymizing information, banks should exercise care to ensure they are not inadvertently revealing confidential client details. For example, a bank may report at the level of client portfolios or business areas. In recent years some banks have gone further

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<sup>40</sup> The GRI recently revised Human rights disclosure framework to align with the recommendations of the OECD Due Diligence Guidance for Responsible Business Conduct.

<sup>41</sup> UN (2011), UN Guiding Principles for Business and Human Rights, (2011), Principle 21, Commentary.

than aggregated reporting by reporting on engagement activities with specific clients, with the latter's consent, or by publishing the names of clients which form part of the bank's portfolio, where such consent is obtained as a condition of financing.

### Measure 6: Provide for or cooperate in remediation when appropriate

6.1. When the enterprise identifies that it has caused or contributed to actual adverse impacts, address such impacts by providing for or cooperating in their remediation.

6.2. When appropriate, provide for or cooperate with legitimate remediation mechanisms through which impacted stakeholders and rightsholders can raise complaints and seek to have them addressed with the enterprise. Referral of an alleged impact to a legitimate remediation mechanism may be particularly helpful in situations where there are disagreements on whether the enterprise caused or contributed to adverse impacts or on the nature and extent of remediation to be provided.

Practical actions for banks	Seeking to use leverage to encourage clients to provide for or cooperate in remediation where they have caused or contributed to adverse impacts.
	Providing for, or cooperating in, remediation where the bank has caused or contributed to the impact.
	Enabling access to remediation by establishing bank-level grievance mechanisms and/or participating in grievance mechanism established by clients, industry initiatives or others.

#### *When should a bank provide or contribute to remediation?*

Where a bank has not contributed to the impact, but the impact is directly linked to its products or services, it is not responsible for providing remedy. That responsibility rests with the client causing the adverse impact. In these circumstances the bank should seek to encourage its client to provide for, or cooperate in, remediation of the impact. The bank may also participate in dialogue or mediation processes with affected stakeholders/rightsholders, where appropriate, to identify how it can strengthen its own due diligence processes so that it proactively identifies similar actual or potential impacts associated with client relationships in the future.

Where a bank recognizes that it has contributed to an adverse impact through its client relationships or other business partners, it should provide for, or cooperate in, the remediation of that impact, in a manner proportionate to its involvement.<sup>42</sup> It should also actively encourage the client to provide remediation appropriate to the client's own contribution. (See Measure 3: Cease, prevent and mitigate adverse impacts). If the client is unwilling to provide remedy, the bank should still provide for, or cooperate in remediation.

<sup>42</sup> Attribution of responsibility, and thus responsibility for remedy, under the MNE Guidelines, is distinct from issues of legal liability and enforcement, which remain largely defined by domestic laws.

However, this should be done in a manner that does not create perverse incentives for the client to evade responsibility.<sup>43</sup>

Legitimate grievance mechanisms can provide a venue for reaching a solution where a bank and stakeholder disagree about whether the bank has contributed to an adverse impact through its client relationship or other business partners.

### *What types of remedy are important?*

The type of remedy or combination of remedies that will be appropriate will depend on the nature and extent of the adverse impact and the views of affected stakeholders. It may include a variety of different forms including apology, restitution, rehabilitation, financial or non-financial compensation, punitive sanctions, or taking measures to prevent future adverse impacts (such as improving due diligence processes).<sup>44</sup> A bank may consider whether it would be appropriate to extend one or more of these forms of remedy even where the harm is being remediated through other legitimate processes. For example, it may be important for the bank to acknowledge the harm suffered and demonstrate efforts to improve its processes to ensure that similar adverse impacts will not recur.<sup>45</sup> Co-operating in remediation does not necessarily mean that the bank will be expected to provide financial compensation to impacted stakeholders, although it may be appropriate in some cases to do so.

### *What processes to enable remediation can banks use?*

Banks can use various processes banks to enable remediation. Legitimate remediation mechanisms can include State-based or non-State-based processes through which grievances concerning enterprise-related adverse impacts can be raised and remedy can be sought. Additionally, non-legal mechanisms can also be an effective in providing remediation. (See Box 2.6 and Box 2.7).

#### **Box 2.6. Examples of potential legitimate remediation mechanisms**

**Legal processes** such as prosecution, litigation and arbitration are common examples of state-based processes that enable remediation.

**Non-judicial state-based mechanisms** such as specialist government bodies, consumer protection agencies, regulatory oversight bodies, environmental protection agencies.

**The National Contact Points** to the OECD Guidelines for MNEs are a State-based non-judicial mechanism through which issues can be raised about implementation of the OECD Guidelines for MNEs in specific instances. (See Box 2.7).

**Operational-level grievance mechanisms** where they meet the core criteria of legitimacy, accessibility, predictability, equitability, compatibility with the OECD Guidelines for MNEs, transparency and being dialogue-based. This term should be understood broadly, to

<sup>43</sup> Ibid.

<sup>44</sup> OECD (2018) Due Diligence Guidance for Responsible Business Conduct, Section II, 6.1 (b)

<sup>45</sup> OHCHR (2017) OHCHR response to request from BankTrack for advice regarding the application of the UN Guiding Principles on Business and Human Rights in the context of the banking sector <https://www.ohchr.org/Documents/Issues/Business/InterpretationGuidingPrinciples.pdf>

cover grievance mechanisms that are set up by a bank, alone or together with other stakeholders, as well as grievance mechanisms established by bank clients or financed projects. (See Table 2.1).

**Global Framework Agreements** between companies and Global Trade Unions, multi-stakeholder grievance mechanisms, community grievance mechanisms, collective bargaining agreements, and enterprise supply chain grievance mechanisms are all examples of non-State-based processes that could enable remediation.

Source: OECD (2018) Due Diligence Guidance for Responsible Business Conduct

Where a client is either providing remediation and/or is being held to account through a legitimate mechanism, it will typically be appropriate for the bank to defer to that process.<sup>46</sup> This is particularly the case where a parallel remediation process could undermine other legitimate processes.<sup>47</sup> Deferring to other remediation processes does not imply a limitation of the bank's responsibility. However, for reasons of accountability and reasonableness, the entity most directly involved with the adverse impact should have the primary responsibility to provide remediation.<sup>48</sup>

However, banks may decide to participate in multiple grievance processes, depending upon the particular needs of the case at hand. Any particular grievance mechanism should not be viewed as a mutually exclusive option for accessing remedy. For example, stakeholders may seek various forms of remedy (i.e. financial compensation, sanction, apology or remediation activity) and as such may choose to access various platforms for seeking such remedies.

### *Do banks need to establish grievance mechanisms?*

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 this respect, banks can choose to establish their own grievance mechanisms or may also participate in mechanisms established by, or in collaboration with, or by other entities (e.g. banking sector initiatives that may be established in the future,<sup>49</sup> or mechanisms established by other sectors or organisations<sup>50</sup>).

Such mechanisms are not expected to be specific to an individual client or established at the level of the specific operation the bank is financing, although banks may also participate in legitimate grievance mechanism established at this level by their clients or other parties.

<sup>46</sup> Ibid.

<sup>47</sup> Ibid.

<sup>48</sup> Ibid.

<sup>49</sup> Most commercial banks have not established grievance mechanism, but inspiration can be drawn from development banks. For example, the Independent Complaints Mechanism established by the Dutch development bank FMO (<https://www.fmo.nl/independent-complaints-mechanism>), the German development finance institution DEG and PROPARCO (Groupe Agence Française de Développement) and the Compliance Advisory Ombudsman (CAO) of the IFC (<http://www.cao-ombudsman.org/cases/>).

<sup>50</sup> For example, the Roundtable on Sustainable Palm Oil (RSPO).

While a grievance mechanism should be able to receive all types of concerns and complaints, it does not have to be designed to provide remedy for all types of issues. In this respect, some complaints may be referred to external processes, for example due to their severity.

Remediation is only one of the roles that grievance mechanisms are intended to serve. Where a bank is involved with an adverse impact, a grievance mechanism can also result in recommendations intended at strengthening a bank's due diligence process. It can also serve as an early warning or feedback mechanism for the bank to alert it to certain issues.

Grievance mechanisms should reflect certain characteristics. The effectiveness criteria for non-judicial grievance mechanisms contained in the UN Guiding Principles on Business and Human Rights provide an important reference point (see Table 2.1 below for more information).<sup>51</sup>

**Table 2.1. Effectiveness criteria for non-judicial grievance mechanisms**

Legitimate	Trustworthy Accountable
Accessible	Known Variety of access points Assistance to overcome barriers
Predictable	Clear procedures Clear timeframes
Equitable	Fair access to information, advice and expertise Fair treatment
Transparent	Keeping parties informed about progress of cases Providing information about the process to build confidence
Rights-compatible	Outcomes and remedies must accord with internationally-recognised rights No prejudice to legal recourse
Continuous learning	Identification of lessons for (i) improving the mechanism and (ii) preventing future harm
Based on engagement and dialogue	Consulting 'users' (including internal users) on design and performance <sup>1</sup>

Source: [A Guide to Designing and Implementing Grievance Mechanisms for Development Projects](#), The Office of the Compliance Advisor/Ombudsman, incorporating the effectiveness criteria for non-judicial grievance mechanisms contained in the UN Guiding Principles on Business and Human Rights

Various resources exist on developing effective grievance mechanisms including in the context of the banking sector.<sup>52</sup> When assessing or designing individual or collaborative grievance mechanisms, banks are encouraged to consult existing resources as well as

<sup>51</sup> See UN Guiding Principles for Business and Human Rights, (2011) Section B, Paragraph 31, [www.ohchr.org/documents/publications/GuidingprinciplesBusinessshr\\_en.pdf](http://www.ohchr.org/documents/publications/GuidingprinciplesBusinessshr_en.pdf).

<sup>52</sup> See for example, OHCHR (2017), Banktrack and Oxfam Australia (2018), *Developing Effective Grievance Mechanisms In The Banking Sector*, [https://www.banktrack.org/download/developing\\_effective\\_grievance\\_mechanisms\\_in\\_the\\_banking\\_sector/2018\\_pa\\_002\\_bank\\_report\\_faweb2\\_3.pdf](https://www.banktrack.org/download/developing_effective_grievance_mechanisms_in_the_banking_sector/2018_pa_002_bank_report_faweb2_3.pdf); Shift: Remediation, Grievance Mechanisms and the Corporate Responsibility to Respect Human Rights, Workshop Report, May 2014, [https://shiftproject.org/wp-content/uploads/2014/05/Shift\\_remediationUNGPs\\_2014.pdf](https://shiftproject.org/wp-content/uploads/2014/05/Shift_remediationUNGPs_2014.pdf)

experts and relevant rights holders to ensure the above effectiveness criteria are adequately reflected.

#### **Box 2.7. NCP specific instances processes: What to expect**

The OECD Guidelines for MNEs have a built-in non-judicial grievance mechanism through the National Contact Points (NCPs). NCPs are established by Adherents to the OECD Investment Declaration. NCPs have the mandate of furthering the effectiveness of the OECD Guidelines for MNEs by: undertaking promotional activities, handling enquiries and contributing to the resolution of issues that arise relating to the implementation of the OECD Guidelines for MNEs in specific instances.\*

Any individual or organisation can bring a specific instance (case) against an enterprise to the NCP where the enterprise is operating or based regarding the enterprise's operations anywhere in the world. NCPs facilitate access to consensual and non-adversarial procedures, such as conciliation or mediation, to assist the parties in dealing with the issues.

Each specific instance proceeding begins with an initial assessment of the submission. As part of this assessment the NCP may reach out to the enterprise(s) involved for their input or feedback on the issues raised. Here, banks involved in a specific instance proceeding would have their first opportunity to understand and respond to issues raised in the submission.

While some NCPs publish initial assessment statements naming the parties and describing the facts and circumstances of a specific instance, other NCPs do not. If a submission is accepted for further examination following the initial assessment, the NCP will offer to provide mediation to the parties through a confidential process aimed at reaching an agreement between the parties. Through this process, parties are given the chance to exchange and explain their views. This may involve one or several meetings between the parties, mediated by the NCP. Some NCPs use a professional mediator.

The specific instance process concludes with a final statement or report by the NCP.

Where the NCP decides that the issues raised do not merit further consideration, the statement includes, at a minimum, a description of the issues raised and the reasons for the NCP's decision.

When the parties have reached an agreement, the statement at a minimum describes the issues raised, the procedures the NCP initiated in assisting the parties and when agreement was reached. The statement only includes information on the content of the agreement insofar as the parties involved agree thereto.

When no agreement is reached or when a party is unwilling to participate in the procedures, the statement at a minimum describes the issues raised, the reasons why the NCP decided that the issues raised merit further examination and the procedures the NCP initiated in

assisting the parties. Where appropriate, the statement may also include the reasons that agreement could not be reached.

The NCP may make recommendations on the implementation of the OECD Guidelines as appropriate, which should be included in final statements and may engage in follow-up with the parties on their response to these recommendations.

Many NCPs allow parties to specific instances to review and provide feedback to final statements before they are published.

\* Specific instances is the term used in the Guidelines to describe practical issues that may arise with the implementation of the Guidelines.

### ***How can bank cooperate in remediation mechanisms while respecting the duty of client confidentiality?***

Grievance mechanisms established by banks for harms related to the activities of clients will not be accessible to stakeholders if they do not know the companies banks are financing. One approach can be to seek consent to publish client names as a matter of practice, as is already done for transactions falling under the Equator Principles and by certain banks as a condition of financing. Clients may also be asked to agree to exceptions to confidentiality provisions where stakeholders wish to pursue a remediation process with banks financing the clients in question.

In order to be accessible, it is important that banks disclose information about the grievance mechanism they have established or participate in. They should encourage clients to do the same in order to inform impacted stakeholders about potential avenues of redress.

## *Conclusion*

Banks play a key role in providing access to financing across industries globally. Carrying out due diligence is a key aspect of risk management which can help enable responsible and sustainable business practices. In addition to contributing to positive impacts, the relationship of banks to negative environmental and social impacts caused by companies they invest in, or finance, is increasingly under scrutiny. Due diligence processes can help banks both know and show their investors, clients and broader public that they are acting responsibly.

This paper has sought to outline how due diligence processes can be carried out by banks in the context of corporate lending and securities underwriting transactions. To date, processes for management of environmental and social risks in the context of the banking sector have often focused on project finance transactions, although general corporate lending and underwriting transactions represent the majority of financing activity by banks. The recommendations provided in this paper can help banks enhance and scale up their RBC risk management processes to ensure they are effectively addressing adverse impacts associated with their portfolios.

Further innovation such as enhancing access to information, promoting inclusion of RBC provisions in standardised loan agreements, and developing collaborative grievance mechanisms for banks will be valuable to facilitating due diligence processes for banks. In this respect banks, policy makers and civil society are encouraged to work together to develop necessary tools, confront challenges and enhance standards and performance in this sector more broadly.



## Annex A. Terminology

The MNE Guidelines include terminology that is also commonly used in the context of general corporate lending and securities underwriting. However, the meaning and application of this shared terminology is different in the context of the MNE Guidelines than in the context of such transactions. Most particularly, the term ‘due diligence’, a central expectation under the MNE Guidelines, is a common ‘term of art’ in both the financial and other sectors, but the meaning differs from that in the MNE Guidelines. To facilitate understanding, this list shows the different meanings of relevant terms in the context of the OECD Guidelines and banking.

Risk	
Terms used under the OECD Guidelines for Multinational Enterprises	<p>☞ <b>“Risk” within the meaning of the MNE Guidelines refers to the existence of real or potential ‘adverse impacts’ on all matters covered by the MNE Guidelines (e.g. disclosure, human rights, employment and industrial relations, environment, combatting bribery, bribe solicitation, extortion, and consumer interests).<sup>53</sup></b></p> <p>It does not refer to financial risk, but rather to risks of adverse impacts when the recommendations of the MNE Guidelines are not respected (e.g. health and safety of workers or the public, adverse impacts on livelihoods, etc.).</p>
Terms commonly used by banks	<p>☞ <b>“Risk” for banks refers to the potential damages which clients and banks themselves face. These impacts are primarily financial and relate to how the capacity of the client to repay its debt would be affected. Risk may also relate to the risk of a bank’s non-compliance with regulations; however, such risks are generally also linked to negative financial impacts to banks.</b></p> <p>Risk categories that can typically be influenced by responsible business conduct (RBC) issues:</p> <ul style="list-style-type: none"> <li>– <i>Credit risk</i>: the risk of a loss deriving from the failure of a client or counterparty to meet its contractual obligation.</li> <li>– <i>Market risk</i>: the risk of a loss which results when the value of an asset (i.e. an investment) decreases due to changes in market factors.</li> <li>– <i>Compliance risk</i>: the risk which results from not complying with rules, regulations, laws, accounting standards, or local or international best practices, which can result in regulatory fines or penalties, including the restriction or suspension of businesses.</li> <li>– <i>Liability risk</i>: the risk which results when a bank, or someone acting on its behalf, faces legal claims when failing to fulfil the obligations, responsibilities, or duties imposed by law or assumed under a contract.</li> <li>– <i>Reputational risk</i>: the risk to a bank’s standing which results from the controversial perception of the bank’s actions and business decisions by its stakeholders.</li> <li>– <i>Environmental and social risk</i>: the risk of a loss which results from poor environmental and social performance by a client. This can also be reflected in reputational risk or compliance risk.</li> </ul>
Differences in terminology and application for this document	<p>The principal difference between these two understandings of risk is the <b>nature of the impacts</b> that they reference. Under the OECD Guidelines, it means broadly, risks external to the bank – risks of adverse impacts (e.g. risk of adverse human rights, labour, and environmental impacts). In the context of general corporate lending and underwriting transactions, it refers to the risk of internal impacts to the bank or the bank’s client.</p> <p>☞ <b>For the purposes of clarity, this paper refers to “risk” as understood under the MNE Guidelines. Such risks can also have financial implications (negative or positive) for the company concerned and thus sometimes “RBC risks” are also financial risks.</b></p>

<sup>53</sup> This paper focuses primarily on risks associated with the human rights, employment and environment chapters of the MNE Guidelines. See section on Scope.

Due Diligence	
<b>Terms used under the OECD Guidelines for Multinational Enterprises</b>	<p>☞ <b>“Due diligence” is the process through which enterprises can identify, prevent, mitigate, and account for how they address their actual and potential adverse impacts as an integral part of business decision-making and risk management systems.</b></p> <p>Due diligence is an ongoing, both proactive and reactive, and process-oriented activity; it is to be conducted throughout the entire life-cycle of operations, products, and service because circumstances change and so will adverse impacts. This means that due diligence should not be limited to an initial investigation of a potential business relationship or transaction, but should also be applied proactively through establishment of systematic measures to identify RBC risk and prevent or mitigate potential adverse impacts, as well as through on-going monitoring of business relationships and related operations.</p> <p>Due diligence is a key aspect of RBC as it is a process for enterprises to ensure that they can 'know and show' their actions in the context of adverse impacts.</p>
<b>Terms commonly used by banks</b>	<p>☞ <b>“Due diligence” for banks is generally understood as a process that is conducted before a transaction is made to identify the risks which may result from it.</b></p>
<b>Differences in terminology and application for this document</b>	<p>The principal differences between the meaning of due diligence in the context of the MNE Guidelines and banking are: under the MNE Guidelines, due diligence is a continuous process, whereas in banking practice, it is carried out prior to engaging in a specific transaction.</p> <p>Under the MNE Guidelines, it is not only the process of identifying issues but also actively managing and accounting for them; whereas in banking practice, it describes processes used to identify potential risk when considering a transaction or client relationship.</p> <p>Under the MNE Guidelines, due diligence aims to avoid and respond to RBC risk; whereas in banking practice it aims to identify financial risk for the client and the bank.</p> <p>☞ <b>This paper only discusses due diligence as understood under the MNE Guidelines and all references made to due diligence should be understood within the meaning of the MNE Guidelines, applied in the context of corporate lending and underwriting transactions.</b></p>

Leverage	
Terms used under the OECD Guidelines for Multinational Enterprises	<p>☞ <b>“Leverage” is an advantage that gives power to influence. In the context of the MNE Guidelines it refers to the ability of an enterprise to effect change in the practices of another party that is causing or contributing to adverse impacts.</b></p> <p>Where a business enterprise is found to be directly linked to an adverse impact through a business relationship, there is an expectation under the MNE Guidelines that it use its leverage to influence the entity causing the adverse impact to prevent or mitigate that impact, acting alone or in co-operation with other entities, as appropriate.</p>
Terms commonly used by banks	<p>☞ <b>“Leverage” for banks is a technical term used to describe: (i) the use of financial instruments or borrowed capital to increase the potential return on an investment, and (ii) the ratio of a company’s debt to the value of its equity, which is a measure of risk.</b></p> <p>However, the word <i>“leverage”</i> is also used in a more colloquial sense to describe the ability to influence a person, a company, or a situation.</p>
Differences in terminology and application for this document	<p>In the context of the MNE Guidelines, leverage is intended to effect change in the wrongful practices of a party causing or contributing to adverse impacts whereas in the context of banking, leverage is primarily a technical term.</p> <p>☞ <b>In the context of this paper, leverage should be understood within the meaning under the MNE Guidelines.</b></p>

Responsible Business Conduct (RBC)	
Terms used under the OECD Guidelines for Multinational Enterprises	<p>☞ <b>Under the MNE Guidelines “responsible business conduct” (RBC) means that business should: i) make a positive contribution to economic, environmental, and social progress with a view to achieving sustainable development; and ii) should avoid and address adverse impacts through their own activities and seek to prevent or mitigate adverse impacts directly linked to their operations, products, or services by a business relationship.</b></p>
Terms commonly used by banks	<p>☞ <b>“Environmental, social, and governance” (ESG) criteria or “Environmental and social risk” (ESR) is the term normally used by financial institutions to describe the set of criteria they use when assessing the sustainability performance of a company.</b></p> <p>Environmental criteria looks at how a company performs as a steward of the natural environment. Social criteria examines how a company manages relationships with its employees, suppliers, customers, and the communities where it operates and often includes human rights and labour rights. Governance deals with a company’s corporate governance – its leadership, executive pay, audits and internal controls, and shareholder rights.</p>
Differences in terminology and application for this document	<p>The scope of RBC and ESG/ESR criteria are related. Both relate to social and environmental considerations, however RBC is broader and specific to the standards and recommendations set out in the MNE Guidelines. ESG/MNE criteria may be used primarily to identify financial risks rather than RBC risks (see above).</p> <p>☞ <b>This paper discusses RBC as defined by the MNE Guidelines.</b></p>

## **Annex B. Overview of Banking transactions: General purpose loans, and underwriting securities.**

To illustrate how the due diligence process works at the level of individual clients and transactions, this paper considers the due diligence process along two typical types of banking transactions in order to illustrate how a bank can address RBC issues appropriately in specific types of transactions. The type of transactions covered by this paper are: General purpose loans, and underwriting securities.

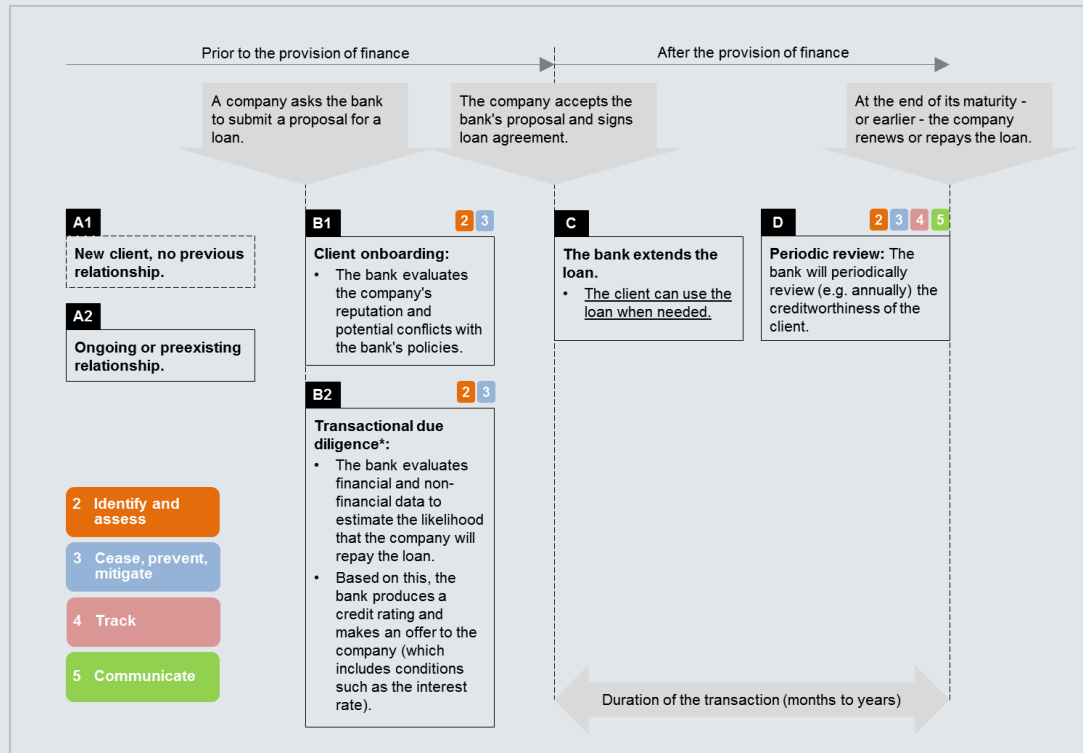
### **A. General purpose loans**

Companies often raise money for general purposes, such as day-to-day corporate expenditure and investments. The bank normally does not know for which precise purpose the loan is intended. Commercial or private real estate often serves as security (collateral) for the loan. Otherwise, with well-established firms in particular, the loan will be provided without collateral, tailored to the client's ability to repay the loan in the future.

A common mode of providing general-purpose loans is through syndicated loans. Syndicated general purpose loans are issued by a group of lenders to a single borrower. The purpose of the syndicate is to spread risk across a group of lenders. Typically, one or several banks, known as arrangers or lead arrangers, may negotiate the terms and conditions of such loan with the Borrower (including generally the negotiation of the financing documentation) and may initially underwrite a large proportion or the entirety of the loan in order to allow the Borrower to secure quickly the financing and to thereafter syndicate such loan to other banks, whilst retaining generally a share of such loans. The other banks are often referred to as syndicate members. Once the loan is signed, the arranger or lead arranger role is terminated and there is usually one bank appointed as agent to liaise between the Borrower and the syndicate members, pursuant to the provisions contained in the financing documentation.

### Box A B.1. Example of integration of due diligence into general purposes loan transactions

When a company needs additional cash, it may approach a bank for a loan. The representatives of the company will meet the bank's relationship manager and ask for a proposal of the terms and conditions that the bank would be willing to offer.



When the bank has no pre-existing client relationship with the company (A1), the relationship manager will initiate the client on-boarding process for this company (B1). This process is either performed by the relationship manager or by a due diligence officer. The overall objective is to assess whether the bank is willing to enter a client relationship with this company. Traditionally, primary concerns have been potential linkages to money laundering, corruption, or other financial crimes.

The client on-boarding process is also the ideal moment for the bank to identify actual or potential adverse RBC impacts that the company may be linked to. It is easier for the bank to identify risks before committing to a client relationship.

When the bank already has an established business relationship with the company (A2), it will initiate the transactional due diligence process. In this case, the client advisor may already have certain information about the company's performance in regards to RBC issues. Otherwise, the client advisor will conduct an assessment and engage with the client when necessary.

The exposure of the company to sectoral, geographic, product and enterprise risk factors will define to what extent the bank will attempt to identify actual or potential adverse RBC impacts. Once significant issues are identified, the bank's Environmental and Social Risk unit (ESR unit) will be contacted to assist with the next steps of the due diligence process.

The ESR unit will engage with the business units to provide a recommendation and/or decision regarding the client relationship or transaction: approve, approve with conditions or decline. Depending on the governance structure of a bank different committees may be involved in reaching a final decision on whether to extend financing.

A first step, the bank may decide to further engage with the company to gain a more comprehensive understanding of the situation.

Once the actual or potential RBC issues are understood, the relationship manager will submit the loan request to the credit committee or additional committee(s) depending on the governance structure of the bank for approval. It may escalate the decision to a higher level committee. The credit committee, and potentially other committees, will review the loan request, assess whether all aspects are in line with bank's policy framework and then either approve, approve under conditions, or reject the loan request and the corresponding terms and conditions. Depending on the size of the transaction, the credit committee may also be involved earlier on, e.g. in early discussions with the company.

The relationship manager informs the client about the bank's decision and offer. Once the client signs the loan agreement the bank will extend the loan (C).

Normally loans undergo some form of periodic review in which the client's creditworthiness is re-evaluated. The review is also used to monitor whether the client meets the conditions stipulated in the loan agreement or other documentation (D). During this review the relationship manager can also assess whether actual or potential adverse RBC impacts are linked to the client.

In lending a transaction normally ends when the client pays the loan back to the bank (sometimes by receiving a new loan from another bank) or when the client renews the loan with the same bank.

## **B. Securities underwriting (raising capital by selling securities to investors)**

Securities underwriting is the process by which investment banks typically raise capital from investors on behalf of corporations or other organizations, such as governmental entities. The investment bank acts as matchmaker. Investment banks will often compete to be awarded underwriting deals. The client selects a lead manager and co-managers. The banks will then work closely with the client towards the successful issuance of the security (debt or equity).

**Box A B.2. Integration of due diligence in securities underwriting transactions**

When a company needs additional cash, it may ask an investment bank to raise capital from third-party investors by selling securities to them (equity or debt). Such a sale can happen either in a private or a public placement. The latter process involves the sale in public markets and requires the approval by a regulator. In some cases it also involves the provision of an independent rating by an independent rating agency.

The company will invite a group of investment banks to submit ideas for such a transaction. Senior representatives of the company will meet senior relationship managers from several banks to discuss the transaction. Depending on the size of the transaction, the company will select one or several banks as lead managers. The lead manager(s) will invite a group of additional banks to join the underwriting syndicate as co-managers.

When the bank has no pre-existing client relationship with the company, the bank's deal team will initiate the client on-boarding process for this company (B1). This process is either performed by the relationship managers, due diligence officers, or a specialized unit in charge of conflict clearance, for example. The overall objective is to assess whether the banks is willing to enter a client relationship with this company. Traditionally, primary concerns have been potential linkages to money laundering, corruption, or other financial crimes – or ethical or legal conflicts resulting from existing client relationships. For this, the bank will conduct a standardized assessment and engage with the company when necessary. During this phase, banks could also attempt to identify actual or potential adverse RBC impacts that the company may be linked with.

As investment banks normally work with very specific groups of clients, the relationship managers will often already maintain long-term personal relationships with company representatives and be familiar with the company's strategy and business model. Also, given that they normally deal with larger companies, they may have prepared a pre-transaction view of the company on RBC issues.

Once the client mandates the lead arranger(s) they will engage in a more detailed due diligence phase. During this phase the lead arrangers will work closely with the company to identify legal, financial, and other risks. Banks are encouraged to use this phase to identify actual or potential adverse impacts the company may cause, contribute to or be linked to. The co-arrangers will primarily focus on sales related activities (D), but are still encouraged to conduct their own due diligence, or at a minimum ensure that the lead arranger is carrying out due diligence effectively. Both, identified risks and actual or potential RBC impacts require appropriate action, including, in cases where the risks are commercially material, encouraging clients to disclose them in the prospectus or brochure that is presented to investors. In contrast to a corporate loan, the client relationship ceases to exist as soon as the securities are sold to the investor and the company receives the capital that has been raised. The bank will aim at maintaining an ongoing client relationship with the company, which can provide the bank with further opportunities to engage on actual or potential RBC issues. However in practice, the bank's leverage over the client will be significantly reduced once the transaction is finalized.