

# THUN GROUP OF BANKS

## PAPER ON THE IMPLICATIONS OF UN GUIDING PRINCIPLES 13b & 17 IN A CORPORATE AND INVESTMENT BANKING CONTEXT

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## EXECUTIVE SUMMARY

### This paper:

- **Builds** on the requirements for sound due diligence as explained in the [Thun Group of Banks' 2013 Discussion Paper](#).
  - **Focuses** on situations where banks may be *directly linked* to negative human rights impacts under UNGP 13b of the UNGPs (UN Guiding Principles on Business and Human Rights).
- **Provides**
  - a conceptual framework to help consider the meaning and reach of UNGP 13b for banks in a corporate and investment banking context; the paper focuses on direct linkage since in a corporate and investment banking context, a bank, is potentially directly linked to adverse human rights impacts under UNGP 13b, although, under UNGP 13a, the provision of certain financial products and services may under exceptional circumstances reach the level of contribution.
  - further consideration of the due diligence envisaged by UNGP 17.
- **Determines that banks should, under the UNGPs:**
  - develop environmental and social (E&S) risk management policies and procedures to support identification, prevention and mitigation of impacts caused and/or contributed to by clients to which the bank provides financial products and services. These policies should include a due diligence as already explained in the 2013 [Thun Group Discussion Paper](#).
- **Introduces the concepts of:**
  - *Proximity* to an impact (ranging from a *low* to *high level of proximity*), which may, based on operational criteria, indicate the “*degree of directness*” of linkage between the impact and the product and service offered by the bank. *Proximity* thus describes a bank’s connection to an impact depending on the *characteristics* of the financial product and service provided. It is therefore an *operational* criterion and must not be confused with *leverage*. It is also not a description of a spatial or geographic relationship between a bank and potential or actual adverse impacts.
  - *Unit of analysis*, as a means to inform the focus of a bank’s due diligence (for example, by reference to the client (company or subsidiary) to which the financial product and service is offered, or asset in the case of specific asset finance).
- **Illustrates**, through case studies, under which circumstances direct linkage may exist, depending on the *unit of analysis*.
- **Clarifies that, in the context of business relationships with clients:**
  - banks are, as with all business relationships, expected to seek to identify both actual and potential adverse human rights impacts and seek to prevent and mitigate them, even if they have not contributed to them.<sup>1</sup> This entails conducting due diligence and, potentially, the use of leverage to try and influence the behaviour and actions of the client causing or contributing to the impacts. Such an approach does not shift responsibility for the impact from the client causing an adverse impact to the bank with which it has a business relationship.<sup>2</sup> In those circumstances, responsibility for the impact remains with the client;
  - when due diligence reveals that a bank may be *directly linked* to an impact caused or contributed to by a client,<sup>3</sup> pursuant to UNGP 22, a bank may take a role in providing for remediation but would not be required itself to do so;
  - the *scope of due diligence* is determined by a combination of the financial product or service offered by the bank and the inherent human rights risk associated with the sector and operating context of the client / transaction (sector, geography, client’s track record etc.);
  - the *duration* of the business relationship and/or the duration of the provision of the financial service impacts the capacity of the bank to monitor the due diligence and mitigation measures over time;

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<sup>1</sup> UNGP 13b

<sup>2</sup> OECD Guidelines for Multinational Enterprises, points 12, 43 (<http://www.oecd.org/daf/inv/mne/48004323.pdf>)

<sup>3</sup> This Paper’s analysis of the degree to which a bank may be considered “linked” to a human rights impact caused or contributed to by a bank’s client should not be interpreted to imply that a bank has any liability (or is deemed to accept any liability) whatsoever for any such human rights impacts.

- o *insufficiency of due diligence* may result in a bank reaching an ill-informed decision but does not generally change the *proximity* of the bank to an impact caused, or contributed to, by a client, nor lead to the assumption of responsibility by the bank for such impacts. In some cases insufficient due diligence may result in the bank's failure to respect human rights. The consequence of this for the bank may be reputational damage and/or potential financial impacts. The primary concern for the bank remains, however, the avoidance or mitigation of the human rights impact;
  - o in many cases, banks' financial products or services *will not be linked* to human rights impacts caused or contributed to by clients. However, depending on the nature of the bank's relationship with the client, the bank may nonetheless seek to improve the situation through active client engagement.
- **Does not cover:**
    - o the adverse human rights impacts that banks may cause or contribute to through their own activities as contemplated under UNGP 13a, notably actions or omissions in a bank's employment practices or its procurement practices, i.e. its supply chain;
    - o in what circumstances a bank's provision of products or services may be deemed to contribute to human rights impacts;
    - o the impacts that banks may be directly linked to in their upstream value chain via their suppliers, and;
    - o the relationship that banks have with their clients in a retail banking, private banking and asset management context (e.g. credit cards, personal loans, mortgages, checking accounts, wealth management etc.). This context is different from other banking services and could be explored separately.<sup>4</sup>

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<sup>4</sup> See e.g. 2013 Thun Group Discussion Paper (<https://business-humanrights.org/sites/default/files/media/documents/thun-group-discussion-paper-final-2-oct-2013.pdf>)

## INTRODUCTION

The Thun Group is an informal group of bank representatives that work together with the primary purpose of i) furthering understanding of the UN Guiding Principles on Business and Human Rights (UNGPs) within the context of banking and, ii) considering how they may be applied across the range of different banking activities. Since its first meeting in 2011, the Thun Group's focus has been on sharing expertise and experience to support the integration of the UNGPs into the policies and practices of banking institutions.

In 2013 the Thun Group published its **first discussion paper**<sup>5</sup> which addressed, from a banking perspective, the corporate responsibility to respect human rights outlined in UNGPs 16–21 (relating to policy development and commitment, scope of potential due diligence, accountability and implementation, and tracking and reporting).

As part of the Thun Group's continued proactive engagement with the UNGPs and deliberations about their implementation, this second paper: i) explores the meaning and reach of UNGP 13b in a corporate and investment banking context; and ii) provides additional guidance around UNGP 17.

### *UNGP 13b*

In accordance with UNGP 13b, banks should “*seek to prevent or mitigate human rights impacts that are **directly linked** to their operations, products or services by their business relationships, even if they have not contributed to those impacts*”. This paper proceeds on the basis that this is the appropriate focus for banks if their clients (in the context of a corporate and/or investment banking relationship) cause or contribute to adverse human rights impacts.

To help understand what “*directly linked*” may mean in the context of corporate and investment banking relationships, this paper considers the different degrees of *proximity* (depending on the type of financial product or service provided) that banks may have to human rights impacts, including by reference to case studies.

The paper also explores why, when it is a *client's conduct* which causes or contributes to a human rights impact and the bank's role does not rise to a level that could be deemed to be a contribution, a bank's role with respect to remedy is properly focused on influencing the actions of the client to provide or contribute to remediation for rights holders.

### *UNGP 17*

This paper supports the position that, even if banks have not caused or contributed to adverse human rights impacts, where *directly linked* banks should still seek to prevent and mitigate such impacts. Banks typically do this via development and adoption of corporate policies and robust management systems to identify risks, perform due diligence and consider mitigation measures that influence the actions of the client causing, or contributing to, the identified impacts. The *proximity* of the bank to the human rights impact, and the definition of the appropriate *unit of analysis* for the specific transaction, may assist the bank in defining the scope of due diligence.

Given this active approach by banks, this paper therefore does not consider instances of complete *omission of due diligence*, but rather explores the consequence of *insufficiency of diligence*. This is explored further below.

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<sup>5</sup> <https://business-humanrights.org/sites/default/files/media/documents/thun-group-discussion-paper-final-2-oct-2013.pdf>, “2013 Thun Group Discussion Paper”

# 1. BANKS' CONNECTIONS TO ADVERSE IMPACTS

## UN GUIDING PRINCIPLE 13

The responsibility to respect human rights requires that business enterprises:

- (a) Avoid causing or contributing to adverse human rights impacts through their own activities, and address such impacts when they occur;
- (b) Seek to prevent or mitigate adverse human rights impacts that are directly linked to their operations, products or services by their business relationships, even if they have not contributed to those impacts.

### Commentary

Business enterprises may be involved with adverse human rights impacts either through their own activities or as a result of their business relationships with other parties. Guiding Principle 19 elaborates further on the implications for how business enterprises should address these situations. For the purpose of these Guiding Principles, a business enterprise's "activities" are understood to include both actions and omissions; and its "business relationships" are understood to include relationships with business partners, entities in its value chain, and any other non-State or State entity directly linked to its business operations, products or services.

Under UNGP 13a, a bank may cause adverse human rights impacts via its *own activities*, notably but not exclusively through actions or omissions in its employment practices that lead to adverse human rights impacts, and through its supply chain. While the provision of wholesale financial products and services may under specific circumstances reach the level of contribution, in an investment banking context banks are, with a sound due diligence process in place according to the criteria outlined in the Thun Group's 2013 Discussion Paper, more likely to be directly linked to adverse human rights impacts under UNGP 13b (see Figure 1). For this reason, the focus of this paper is on direct linkage according to UNGP 13b.

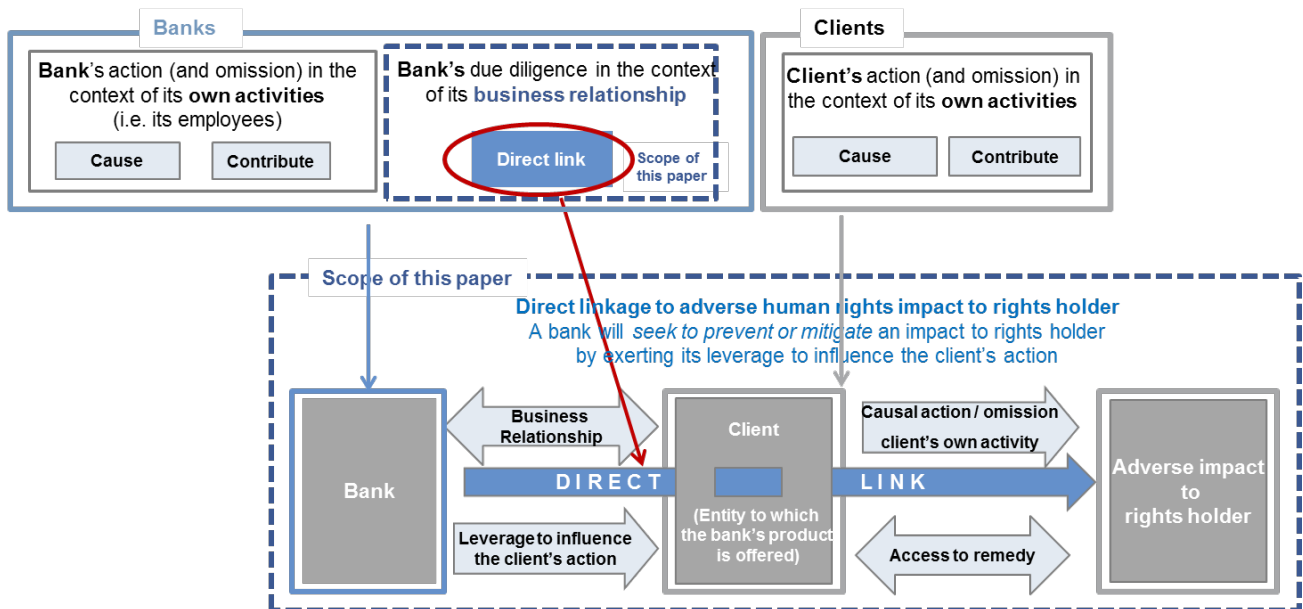


Figure 1 – Direct linkage in the context of business relationship

Recent specific instances handled by OECD National Contact Points demonstrate how banks can be directly linked to adverse human rights impacts through the provision of their financial products and services.<sup>6</sup> The case studies provided in this paper consider the circumstances in which such a direct linkage might be established.

The interactions banks have with their clients vary according to the type of financial products and services provided (corporate loans, debt and equity issuances, trade finance etc.). Consequently, the nature of the linkage of a bank to an impact caused or contributed to by its client's activities also varies. The potential strength or "directness" of linkage (which we will call *proximity*) to an impact warrants further exploration, given the myriad financial products or services that exist with differing levels of *proximity* to any underlying outcome / impact. *Proximity* as used in this paper refers to the characteristics of a product or service and is therefore an operational criterion. It must not be confused with leverage or concepts of "sphere of influence". Rather it describes a bank's connection to an impact depending on the *characteristics* of the financial product and service provided in a specific context. It is also not a description of a spatial or geographic relationship between a bank and potential or actual adverse impacts.

Due diligence applies across all activities of a bank and is not a one-time process but takes place in different forms in different contexts. With regard to a specific product or service, one of the most important determinants of a bank's ability to assess and manage human rights related risk in a business relationship with a client effectively is the *proximity* to the potential impact. This *proximity* is determined by the type of financial product or service offered to the client and assists the bank in defining the specific applicable level of due diligence with a view to the potential impacts and the given unit of analysis.

The sector and operating context / geography and regulatory environment will also provide an initial indication of the degree of human rights due diligence that would be feasible and appropriate (for example, a loan to a renewable energy company in the UK may require less due diligence than a loan to a mining company in an emerging market). It is further informed by the underlying nature of the business, potential for human rights impacts and the track record of the client.

Apart from asset-specific financing (project financing or other forms of lending or capital raising where the use of proceeds is destined for a specific asset), the vast majority of financial products or services a bank will provide to a client will be at a corporate<sup>7</sup> level, for example through general corporate purpose loans, bond or equity issuances, or advisory mandates. This is relevant as the client to whom the financial product or service is being provided will be the *unit of analysis* for due diligence purposes.

- For asset-specific financing the *unit of analysis* is primarily the asset itself, where the bank will determine the human rights impacts of the physical operations of that asset and, where appropriate, undertake a review of the project sponsor's commitment, capacity and track record to manage potential risks. When undertaking asset-specific due diligence, banks should adopt a comprehensive approach to addressing human rights risks and require a human rights impact assessment where material human rights risks are identified. The Equator Principles and the IFC Performance Standards may be applied in this regard. Apart from the severity of potential human rights impacts, the due diligence will also be scaled by the complexity of the project (i.e. a project requiring large scale resettlement or land acquisition would require more complex due diligence than projects with a limited spatial footprint).
- For the provision of financial products and services at a corporate level, however, the *unit of analysis* from a due diligence perspective is the client itself, and the bank will therefore consider human rights impacts at the corporate level. Here, the due diligence will typically focus on the client's human rights commitment and management approach, as well as an assessment of any negative information related to human rights issues across the client's assets.
- Due diligence at a corporate level may include asset-specific diligence where it is determined that actual human rights impacts are present in respect of a specified asset. However, the level of information the bank might be capable of obtaining, and the consequent ability of the bank to require the client to address the issue, can be limited if there is no direct financing of the asset in question.

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<sup>6</sup> Examples: <http://www.oecdguidelines.nl/documents/publication/2015/1/6/ncp-initial-assessment-abp-agg---somo-bothends>; <http://www.oecdguidelines.nl/documents/publication/2016/1/15/fs-foe-milieudefensie-rabobank>

<sup>7</sup> "Corporate" refers in this case to listed or private businesses, including holding companies.

Figure 2 provides a visualization of possible *units of analysis* in the context of project and corporate financing. Some of these “models” will be further explained through case studies.

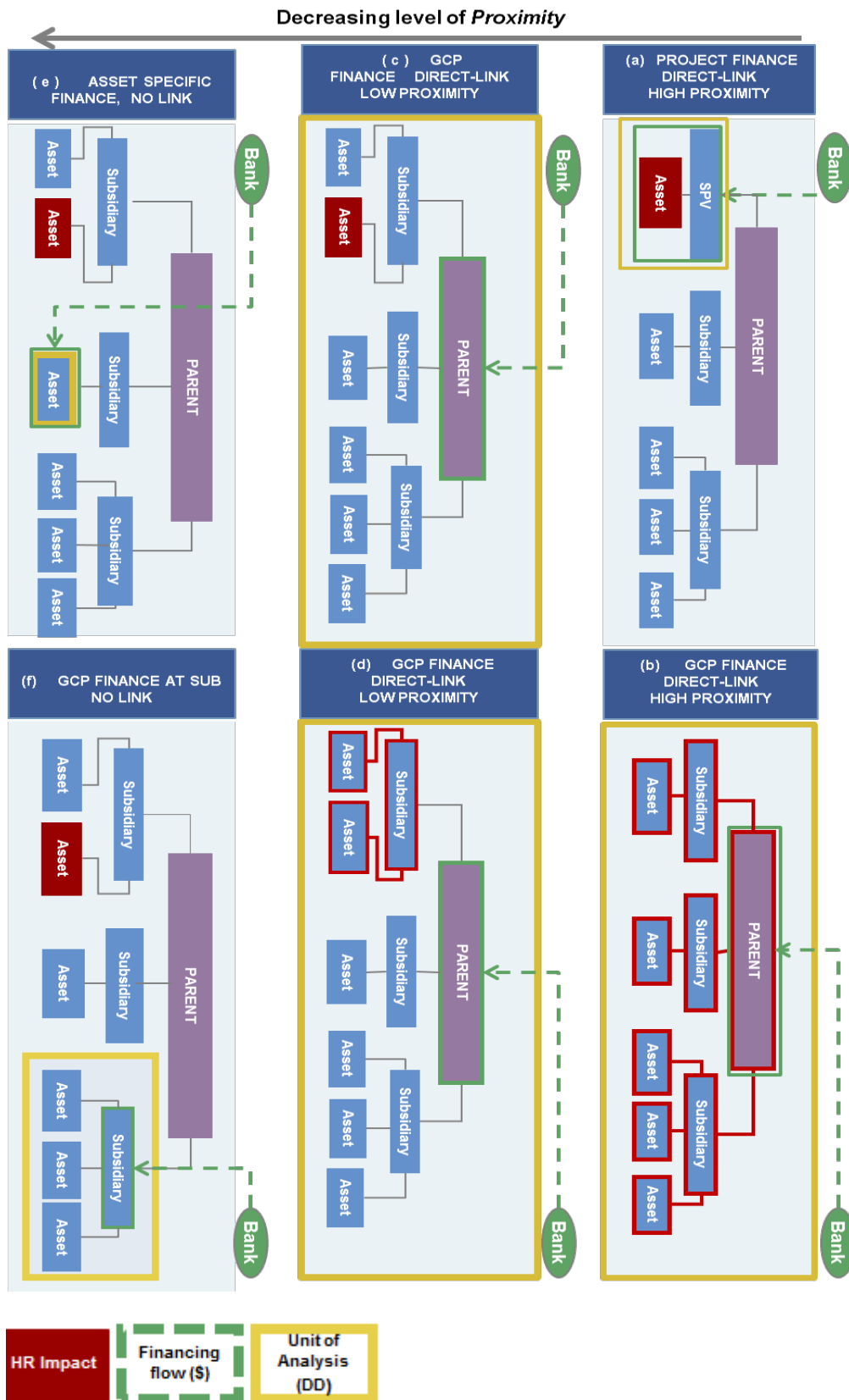


Figure 2 – Units of Analysis (Note: GCP: General Corporate Purpose; SPV: Special Purpose Vehicle)



As explained above, depending on the type of financial products or services offered, apart from situations of contribution which are not within the scope of this paper, a bank may have either i) a direct link with varying proximity to an adverse human rights impact caused, or contributed to, by its client, or ii) no linkage at all.

- **Direct linkage** (see Figure 2, cases a, b, c and d): if the adverse impact is occurring within a specific entity of a client and the bank's financial products or services are dedicated to this entity (i.e. asset financing), then the bank may have a **direct linkage with high level of proximity** to an adverse human rights impact. This would apply, for instance, in cases involving project finance advisory or project financing, project-related corporate loans and other asset financing products or services, as outlined in the chart in case (a).

If adverse impacts are occurring throughout the client's operations and entities, and the bank is providing a general corporate purpose (GCP) loan to the parent client, the bank may also be deemed to have **direct linkage with high level of proximity** to the impacts. This is outlined in case (b) of the chart. The different units of analysis between case (a) and (b) impact the nature and depth of information obtained.

If the adverse impact occurs at a subsidiary or asset within the client but the bank is providing GCP financing or advice to the parent company, direct linkage may remain but with only **low level of proximity**. This is outlined in cases (c) and (d).

- **No linkage** (see Figure 2, cases e, f): if the adverse impact is the result of a specific entity's, subsidiary's or asset of a company's action and the bank is providing financial products or services to another entity, subsidiary or asset of the company, then there would be no linkage between the bank and the adverse human rights impact. Example cases are outlined in (e) and (f).

As can be seen from Figure 2, the bank's due diligence process and subsequent mitigation efforts may therefore vary depending on the different scenarios outlined above. The 2013 Thun Group Discussion Paper has already articulated how the human rights due diligence process applies to banks under UNGP 17. The following analysis builds on the Thun Group of Banks' 2013 Discussion Paper and aims to provide additional guidance in respect of this UNGP in the context of a bank's direct linkage to the impact through the provision of financial products or services. This paper will now consider in more detail what factors may govern the due diligence process and explore the types of mitigation measures that may be employed as a result.

## 2. DUE DILIGENCE APPROACHES FOR BANKS

<b>UN GUIDING PRINCIPLE 17</b>
<b>Human rights due diligence</b>
<p>In order to identify, prevent, mitigate and account for how they address their adverse human rights impacts, business enterprises should carry out human rights due diligence. The process should include assessing actual and potential human rights impacts, integrating and acting upon the findings, tracking responses, and communicating how impacts are addressed. Human rights due diligence:</p>
<p>(a) Should cover adverse human rights impacts that the business enterprise may cause or contribute to through its own activities, or which may be directly linked to its operations, products or services by its business relationships;</p>
<p>(b) Will vary in complexity with the size of the business enterprise, the risk of severe human rights impacts, and the nature and context of its operations;</p>
<p>(c) Should be ongoing, recognizing that the human rights risks may change over time as the business enterprise's operations and operating context evolve.</p>

When a bank, as part of its due diligence process, identifies that it may have a direct linkage to adverse human rights impacts (actual or potential) through its products or services, it should seek to prevent or mitigate those impacts. A bank will undertake *specific due diligence* scaled according to the complexity and/or size of the client's business and the severity of the actual or potential human rights impacts identified. The Thun Group's 2013 discussion paper provides further details on this.

The due diligence and mitigation measures should be monitored / evaluated periodically for the *duration of the client relationship* or the *duration of the provision of the financial service*. The case studies in the Appendix demonstrate the circumstances under which a bank may undertake due diligence when taking into consideration the financial products or services being offered and the sectors and geographies involved.

It should be borne in mind that, in the context of asset-specific financing for new assets / assets under construction, banks will typically undertake due diligence which is premised on the *potential* for a human rights impact to happen as the impact will seldom, if ever, have already occurred. Certainly, when considering an asset-specific finance, the Equator Principles require categorisation of the potential E&S risks that might occur in the future. The same is often true in a more general corporate level financing where a bank will take a risk-based approach. Where the risk for *potential* human rights impacts associated with a client's activity is identified (i.e. sector, geography, negative track record associated with the client, etc.), the bank will perform *further diligence*. It will consider the client's plans and commitments to avoid, mitigate or manage potential future human rights impacts effectively, including how the client has managed any human rights impacts that have occurred previously.

Where it is determined that the client may not have appropriate prevention, mitigation or management mechanisms in place in light of the actual or potential human rights impacts, the bank shall endeavour to use its *leverage* or influence to require enhanced commitments or undertakings from the client to ensure that these risks are effectively managed. The nature of the *mitigation or management mechanisms* that a bank can put in place can vary depending on the type of financial products or services provided and any *residual risk* identified during the course of the due diligence process. A *residual risk* occurs when the client's E&S policies and procedures are not sufficient and therefore additional mitigation measures are needed (see also section "Preventing and Mitigating Adverse Impacts" below). Depending on the outcome of the due diligence and the client's commitment to mitigate potential human rights impacts, the bank will determine whether to maintain its participation or exit a particular transaction and/or in some cases the client relationship.

Figure 3 illustrates the due diligence process in the context of a bank's business relationship.

Should a bank be dissatisfied with the client's commitment and therefore decide to decline to participate in a transaction or exit the client relationship, this will not necessarily prevent the client from continuing to violate human rights. This concept is further developed in the section "Important Considerations" below.

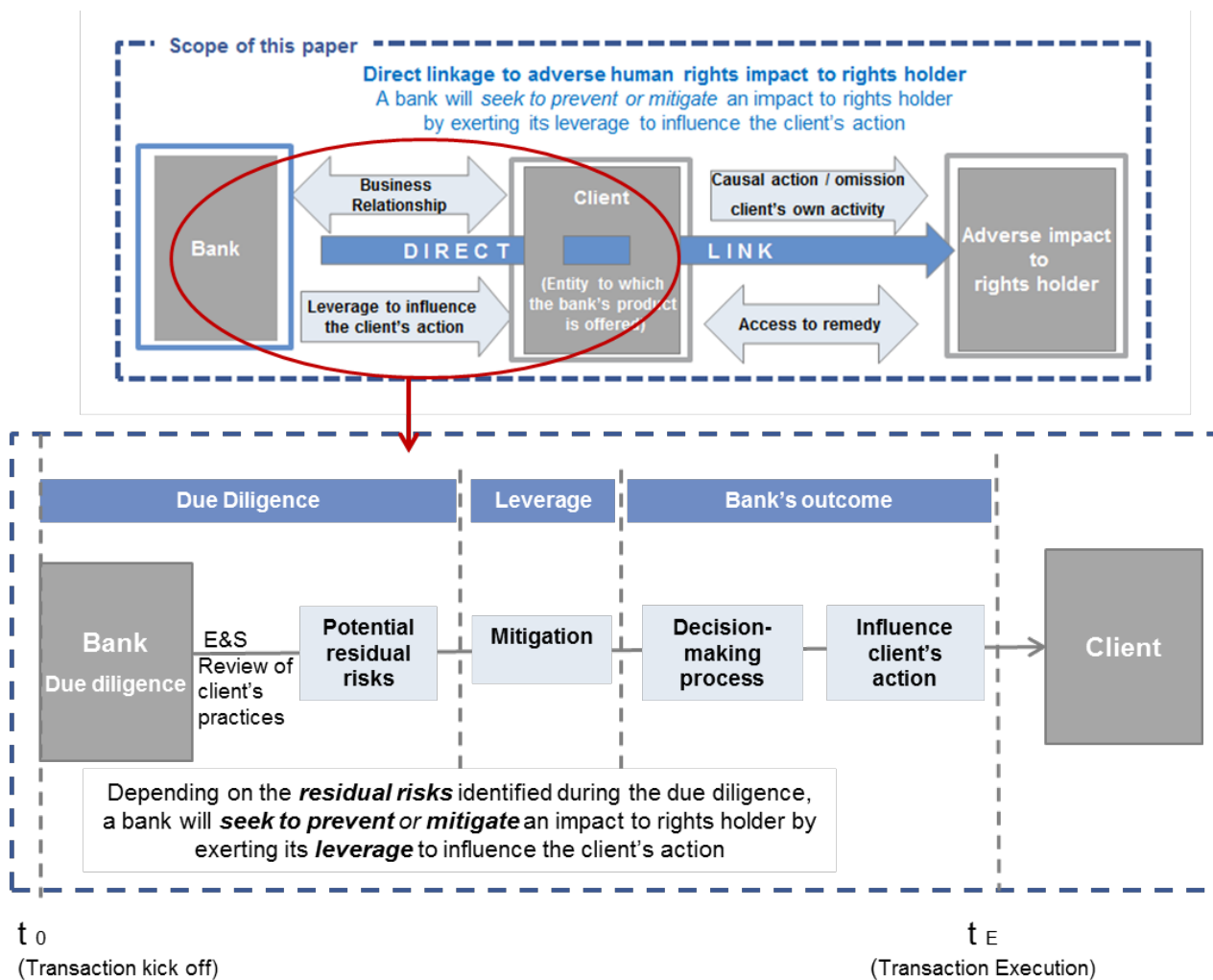


Figure 3 – Due diligence process in the context of a bank's business relationship

The topic of leverage or influence within the context of a financial institution's client relationship is presented in a report commissioned on behalf of the OECD Working Party on Responsible Business Conduct, titled "*Environmental and Social Risk in the Financial Sector: Current approaches and practices*"<sup>8</sup>. On pages 53-74 of the report, there is a summary of the authors' findings based on interviews with a number of financial institutions (we focus on banks for the purposes of this paper), as well as a series of case studies where a bank may try to use leverage or influence to require that the client enhances its management of potential (or actual) human rights impacts.

The report broadly concluded that leverage, or the ability of a bank to effect a change in a client's behaviour, is not a linear exercise and instead depends on a variety of factors, including: the amount of funding, the tenor of the funding, the nature and strength of the relationship with the client, the number of other banks involved and the potential for the bank to be negatively associated with the impact. As also outlined in the 2013 Thun Group Discussion Paper (p. 5) we would agree with this summation, as the ability to exert influence over a client's actions, where legally permissible, is resolved on a case by case basis, taking into account all relevant factors.

With regard to the periodic nature of due diligence contemplated by UNGP 17 (c), this will again differ according to the financial product or service in question and the *duration* of the business relationship and/or financial product or service offered. In particular:

- Where an engagement with a client is *short term* (e.g. advisory, capital markets underwriting, short term trade finance) there may be limited, if any, ongoing interaction with the client beyond the transaction and the due diligence

<sup>8</sup> [http://mneguidelines.oecd.org/global-forum/2013\\_WS1\\_1.pdf](http://mneguidelines.oecd.org/global-forum/2013_WS1_1.pdf)

is predominantly *ex ante* only, as the bank may cease to be involved with the client once the transaction has concluded;

- Where the financial product or service is *medium to long term* (e.g. asset finance, medium to long term loan) there is more opportunity to undertake periodic due diligence and influence the client's behaviour and activities over time where appropriate. This will often take the form of covenants in loan agreements requiring that the client continues to address any potential human rights impacts and provide the bank with updates on progress, particularly in the case of asset financing (monitoring)<sup>9</sup>;
- Where a bank has an *ongoing relationship* with a client it can undertake a periodic risk based review of the relationship. Where a material negative human rights impact is discovered during the periodic review or at any other point in time, the bank should seek to engage with the client on the issue where possible. As noted above, the effectiveness of the engagement will vary depending on the combination of leverage "factors".

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<sup>9</sup> For the purpose of this analysis and development of case studies, this paper considers: (i) "Time 0", as the time when due diligence starts; (ii) "Time E", as the time when the transaction is executed/completed; and "Time M" for longer term transactions that include monitoring (see fig 3 and 4). A bank's influence is greatest between Time 0 and Time E when the financing decision is being made.

### 3. IMPORTANT CONSIDERATIONS

#### Relationship between a bank’s proximity to impact and its applied due diligence process in the context of a specific transaction.

As discussed previously, the *proximity* to the impact is generally determined at the outset by the type of financial product or service being offered. The level of due diligence undertaken is determined by a combination of the financial product or service offered by the bank and the inherent human rights risk associated with the operating context of the client or transaction (sector, geography, client’s track record etc.). Should human rights concerns arise prior to and/or during the course of the due diligence process, a bank should seek to prevent or mitigate material adverse human rights impacts that are directly linked to their operations, products or services via a business relationship. Again, this is not intended to shift responsibility for impact from the entity causing an adverse impact to the enterprise (e.g. a bank) with which it has a business relationship.

The Thun Group’s 2013 Discussion Paper highlighted the importance of undertaking human rights due diligence. *Insufficiency of due diligence* (e.g. where relevant information was not accessible with appropriate effort at the time of the due diligence) may result in a bank reaching an ill-informed decision but does not generally change the *proximity* of the bank to an impact caused, or contributed to, by a client (see fig 4). In some cases insufficient due diligence may result in the bank’s failure to respect human rights. The consequence of this for the bank may be reputational risk and/or potential financial impacts. The primary concern for the bank remains, however, the avoidance or mitigation of the human rights impact.

#### Relationship between outcome of a bank’s due diligence and outcome for rights holders.

Depending on the outcome of a due diligence exercise (e.g. identification of potential residual risks) and the client’s commitment to mitigate potential human rights impacts, a bank will determine both whether or not to proceed with a transaction and/or client relationship, and where applicable, on what conditions to proceed. As expounded further in the case studies, the decision-making process undertaken by the bank specific to a transaction and/or relationship may influence the client that caused or contributed to an impact. However, as shown in Figure 4, this does not shift proximity, nor does it establish a causal link to the impact on the rights holder. Responsibility for the impact remains with the client to which the bank is providing the financial product or service. In such circumstances, the bank will use its leverage to seek to prevent or mitigate the impacts for the duration of the financial product or service offered but may have no influence on the client’s actions and impacts on rights holders once the relationship is terminated or the transaction is completed. .

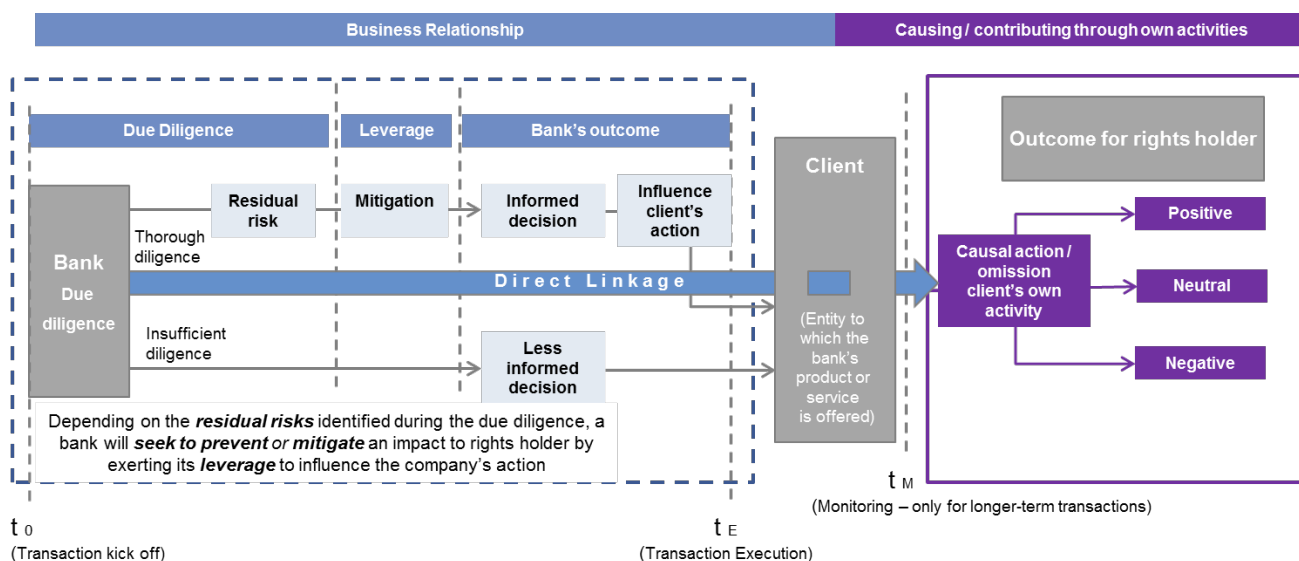


Figure 4 – Outcome of a bank’s due diligence and outcome for rights holders

## 4. PREVENTING AND MITIGATING ADVERSE IMPACTS

### **Preventing and mitigating adverse human rights impacts in the context of direct linkage.**

As per the UNGPs, when a company has a *direct linkage* to adverse human rights impacts through its products or services, it should seek to prevent or mitigate those impacts. Depending on the financial product or service the bank can include recommendations and/or requirements that the client: hires a qualified independent consultant, implements a human rights policy, develops action plans, improves engagement with local communities and establishes an effective grievance mechanism, provides progress reports or enhances public disclosure. For certain medium to longer term financial products or services the bank may covenant such recommendations and/or requirements into contractual agreements.

Such measures reflect the bank exerting its leverage to prevent or reduce adverse human rights impacts caused or contributed to by its client. In some cases, the bank may have very limited options to use or increase the degree of leverage available. Depending on the outcome of the due diligence and evidence of the client's commitment, capacity, and track record, the bank's decision may simply be whether or not to continue to participate in the transaction or maintain a client relationship. More detailed examples are provided in the case studies.

### **Preventing and mitigating adverse human rights impacts relating to a client relationship but where there is no direct linkage.**

In many cases a bank's financial products or services are not linked to human rights impacts caused or contributed to by one of the client's entities. However, depending on a bank's relationship with the client, it may still seek, as part of its overall relationship management, to improve the situation through active client engagement. For example, as part of its corporate responsibility to respect human rights, a bank may use its leverage, where feasible, to ensure the client undertakes community consultation and has operational level grievance mechanisms in place where appropriate.

The following case studies demonstrate the various levels of due diligence and leverage that banks can exert, as well as possible mitigation measures that can be implemented depending on the combination of factors explored in this paper.

## 5. CONCLUSION

This paper has considered the meaning and reach of UNGPs 13b and 17 for banks in a corporate and investment banking context. In conclusion:

- 1) Banks should, under the UNGPs, develop environmental and social (E&S) risk management policies and procedures to support identification, prevention and mitigation of impacts caused and/or contributed to by clients to which the bank provides financial products and services. These policies should include a requirement to perform due diligence on higher risk transactions and/or clients, as already explained in the 2013 [Thun Group Discussion Paper](#).
- 2) With a sound due diligence process in place according to the criteria outlined in the Thun Group's 2013 Discussion Paper, a bank's connection to an adverse human rights impact in an investment banking context will in most cases be one of *direct linkage* as addressed by UNGP 13b rather than of causation or contribution under UNGP 13a. There are two important concepts to consider when describing the business relationship between a bank and a client for the purposes of UNGPs 13b and 17:
  - o *Proximity* to an impact, which may, based on operational criteria, indicate the “*degree of directness*” of linkage between the impact and the product and service offered by the bank. *Proximity* thus describes a bank's connection to an impact depending on the *characteristics* of the financial product and service provided. It is therefore an *operational* criterion and must not be confused with *leverage*. It is also not a description of a spatial or geographic relationship between a bank and potential or actual adverse impacts.
  - o *Unit of analysis*, as a means to inform the focus of a bank's due diligence (for example, by reference to the client (company or subsidiary) to which the financial product and service is offered, or asset in the case of specific asset finance). In this paper we have discussed the circumstances under which direct linkage may apply depending on the unit of analysis.
- 3) In the context of business relationships with clients a bank may, in certain circumstances, be *directly linked* to an impact caused or contributed to by a client. In this context, pursuant to UNGP 22, a bank may take a role in providing for remediation but – unlike in situations of contribution and causation – is not required to provide the remediation itself.
- 4) When directly linked to adverse impacts, banks are expected to seek to identify, prevent and mitigate such impacts. This entails conducting due diligence and, potentially, the use of leverage to try and influence the behaviour and actions of the client causing or contributing to the impacts. Such an approach does not shift responsibility for the impact from the client causing an adverse impact to the bank with which it has a business relationship. In those circumstances, responsibility for the impact remains with the client.
- 5) A number of factors are considered when conducting due diligence:
  - o The *scope of due diligence* is determined by a combination of the financial product or service offered by the bank and the inherent human rights risk associated with the sector and operating context of the client / transaction (sector, geography, regulatory environment, client's track record etc.);
  - o The *duration* of the business relationship and/or the duration of the provision of the financial service impacts the capacity of the bank to monitor the due diligence and mitigation measures over time;
  - o In many cases, banks' financial products or services *will not be linked* to human rights impacts caused or contributed to by clients. However, depending on the nature of the bank's relationship with the client, the bank may nonetheless seek to improve the situation through active client engagement.
- 6) Regarding the outcome of *a bank's due diligence*:
  - o The *outcome* may influence the action of the client (who is causing and/or contributing to a human rights impact) to prevent or mitigate those impacts, but may not necessarily influence the *outcome for rights holders directly*;
  - o *Insufficiency of due diligence* may result in a bank reaching an ill-informed decision but does not generally change the *proximity* of the bank to an impact caused or contributed to by a client. In some cases insufficient due diligence may result in the bank's failure to respect human rights. The consequence of this for the bank may be reputational damage and/or potential financial impacts. The primary concern for the bank remains, however, the avoidance or mitigation of the human rights impact.

## Annex – CASE STUDIES

The case studies below have been prepared with the objective of assessing the following characteristics:

- I. **Proximity** to human rights impact: is informed by the financial product or service being requested by / offered to the client;
- II. **Due Diligence:** this analysis assumes that banks have policies and management systems in place to address human rights risk, and perform due diligence. The level of due diligence undertaken is determined by a combination of the financial product or service offered by the bank and the inherent human rights risk associated with the sector and operating context of the client / transaction (sector, geography, company's track record). *The duration* of the business relationship and/or the duration of the provision of the financial service determine the capacity of the bank to continue the *due diligence* and to advise and monitor the implementation of the client's mitigation measures over time;
- III. **Leverage:** when *residual risks* are identified during the course of the due diligence, the bank is expected to exert its *leverage* to seek to prevent and mitigate the impacts caused and/or contributed to by clients to whom the bank provides financial products and services. Under these circumstances, the bank will encourage the client to implement *mitigation measures* and will seek to influence the *actions* of the client to whom it provides financial services. *Leverage* depends on a combination of factors, including but not limited to the strength of the relationship with the client, the size / tenure of the transaction, presence / influence of other stakeholders, and the client's ability to access alternative sources of finance;
- IV. **Outcome for the bank:** banks should perform due diligence in order to identify risks associated with both the transaction and the client. This allows the bank to *make an informed decision* before a transaction is executed. Once the transaction is completed and/or after the business relationship has ended, the bank's ability to influence the client's actions towards the rights holders becomes limited;
- V. **Outcome for the rights holder:** the extent to which material adverse human rights impacts have been identified during the course of the bank's diligence process and remediated by the client that causes or contributes to the impacts. In particular a) material adverse human rights impacts have been identified and *mitigation measures implemented* by the client that has caused and/or contributed to the impacts, even after a transaction is executed and the business relationship has ended; and (b) *Access to Remedy* is provided to rights holders by the client that causes or contributes to the impacts.



The template below has been applied to each case study to ensure a consistent approach.

Case study #	Key characteristics	Key considerations
	Case	Unit of analysis
1. Proximity to human rights (HR) impacts	Informed by the type of <b>financial product or service</b>	<ul style="list-style-type: none"> <li>• Direct linkage with high level of proximity</li> <li>• Direct linkage with low level of proximity</li> <li>• Not linked</li> </ul>
2. Due Diligence (DD) ( $t_0 - t_e$ ) ( $t_m$ where applicable) <sup>10</sup>	Flexed / Scaled by <b>the underlying human rights related risk</b> , i.e. including consideration around the sector profile and location of client's activities	<ul style="list-style-type: none"> <li>• Asset specific</li> <li>• Corporate level</li> <li>• Country specific risks (i.e. conflict areas)</li> <li>• Specific issues / allegations</li> </ul>
3. Leverage	Used to encourage the client to manage any <b>residual risk</b> e.g. engagement of consultant, action plan	<ul style="list-style-type: none"> <li>• High</li> <li>• Medium</li> <li>• Low</li> </ul>
<b>Outcome (for bank)</b>		
4. Decision-making	<b>Determine go / no-go</b> based on level of concerns and client's commitments (e.g. covenant action plans, disclosure), and the bank's overall risk appetite	The bank takes an informed decision <ul style="list-style-type: none"> <li>• Approved</li> <li>• Approved with condition</li> <li>• Rejected / exit relationship / transaction</li> </ul>
<b>Outcome (for rights holder)</b>		
5. Actual human rights impact	After mitigation measures have been agreed, were they implemented and monitored for effectiveness? Has a remedy been provided by the client-related entity who caused or contributed to the human rights impact?	<ul style="list-style-type: none"> <li>• High adverse impact</li> <li>• Medium adverse impact</li> <li>• Minimal impact</li> <li>• Positive (If the client provided remedy)</li> <li>• Unknown</li> </ul>

For each case study different post-transaction outcome scenarios have been considered, from the rights holder perspective, from high / medium / minimal adverse impact, to positive impacts.

These scenarios facilitate a discussion on whether or not the outcome of a bank's due diligence process is related to the outcome from the rights holder's perspective. They also aim to explore whether a bank can be directly linked (or not linked) to the harm once the transaction has been executed.

<sup>10</sup> For the purpose of this analysis and development of case studies, this paper considers: (i) "Time 0", as the time when due diligence starts; (ii) "Time E", as the time when the transaction is executed/completed; and "Time M" for longer term transactions that include monitoring (see fig 3 and 4)

## 1. Case study #1

**Asset based financing for a toll road project** in Latin America. Pre-transaction due diligence was undertaken. Minor human rights issues were identified and mitigation actions were agreed and included in an action plan. However, after financial closure, the independent consultant site visit identified several labour / human rights issues including excessive overtime, inadequate food and sanitation and harassment of construction workers by road users.

Case study 1	Key characteristics	Key considerations
	Case: Project related corporate loan for the development of a toll road.	Unit of analysis: The project (toll road) and the SPV (See fig 2. (a))
1. Proximity to human rights impacts	Labour and working conditions issues associated with the company's activity at the project site.	<i>Direct linkage with high level of proximity</i> due to asset specific finance
2. Due Diligence (DD)	DD involved the review of the facility agreement and Engineering Procurement Construction (EPC) contract. Key social issues identified included resettlement and security. An independent Environmental & Social Consultant was hired and the client agreed on material issues to be closed out prior to financial close. During the monitoring reviews the consultant identified residual risk, and additional diligence has been carried out post financial close.	Project specific
3. Leverage	High leverage considering the financial product. E&S clauses included in the loan agreement.	High
<b>Outcome (for bank)</b>		
4. Decision-making	Additional material risk issues around labour overtime and workers' accommodation were identified post financial close as part of the ongoing monitoring; those newer issues were incorporated into a revised Action Plan (originally developed pre-financial close and covenanted in the facility agreement).	Approved with conditions
<b>Outcome (for rights holder)</b>		
5. Actual HR Impact	<p>After the implementation of the company's action plan, working conditions have improved.</p> <p>Among the various measures included in the Action Plan, the bank ensures that the company provides <i>grievance mechanism</i> to rights holders.</p> <p>Through the provision in the loan documentation, the bank can monitor performance after financial close.</p>	<p>Medium adverse impact</p> <p>Access to remedy provided by the client to whom the bank provides finance</p>

## 2. Case study #2

An investment bank is asked to provide **IPO** underwriting for the Hong Kong listing of an Asian mining company's **African assets**. Poor labour and HSE practices at African operations attract NGO campaigns, prompting Hong Kong Stock Exchange (HKSE) to ask further E&S questions before allowing the listing to proceed. The bank seeks to engage the management of the Asian mining company on identified E&S issues. The bank requires that the company puts in place improved labour management practices and a grievance mechanism via an action plan.

Case study 2	Key characteristics	Key considerations
	Case: IPO of African mining assets (asset specific product).	Unit of analysis: The African asset (see Fig. 2 (a))
1. Proximity to human rights impacts	Labour and working conditions impacts experienced at the company assets.	<i>Direct linkage with high level of proximity</i> because of asset specific product
2. Due Diligence (DD)	The DD is undertaken at the asset level (for each of the assets of the client that was listed) and is scaled according to the risks associated with the sector and geography of the client as well as the allegations of HR abuses at the site. Parallel to the bank's DD, the Hong Kong Stock Exchange (HKSE) expresses concerns over the company's labour practices and a reputable NGO issues a report on the issue. The bank conducts DD around the company's labour policies, practices and track record, and includes a site visit involving an independent consultant to carry out interviews with management and employees.	Asset specific site visit focusing on human rights and labour
3. Leverage	<p>This is a new relationship for the bank. The bank can leverage the public nature of the transaction and investor expectations. However, the direct linkage to the impact ceases after the execution / launch of the IPO, and therefore the bank will not be able to monitor ongoing human rights performance at the asset as there will be no contractual obligation linking the client to the bank post-IPO.</p> <p>The combination of the HKSE warning about poor labour conditions, HSE practices and the NGO report increased the level of influence the bank was able to exert with the client. To manage residual risk, the bank requested, as a condition to the IPO, that the company hire an external consultant to assess the situation and put in place improved labour management practices and a grievance mechanism via an action plan. An initially weak relationship was converted into a strong relationship when the bank was able to successfully support the company in resolving its E&amp;S issues, thus giving HKSE the comfort it sought prior to listing. Moreover, inclusion of the action plan and commitments in the IPO prospectus provides continuing leverage arising from the relationship and obligations of the client to investors in the IPO.</p>	Medium to high

<b>Outcome (for bank)</b>		
4. Decision Making	The bank approves participation in the IPO after requesting the company to disclose the above mentioned Action Plan and its commitments to maintain labour management best practice and a grievance mechanism in the IPO Prospectus.	Approved with conditions
<b>Outcome (for rights holder)</b>		
5. Actual human rights Impact	<p>Prior to the transaction execution, following the implementation of the company's action plan and the introduction of a grievance mechanism, labour practices have improved.</p> <p>Due to the nature of the transaction, the bank has very limited ability to monitor the company's implementation of the mitigation measures / Action Plan and seek remediation if issues are identified post transaction.</p>	Positive

### 3. Case study #3

A bank is involved in a **bilateral lending** for a cement production company, whereby the proceeds shall be used for an expansion of one of their **cement projects** in Central America. Issues identified during the due diligence include allegations of human rights violations as well as contextual issues related to the “duty of State to protect”. In addition, there was a lack of sufficient time to undertake the necessary due diligence.

Case study 3	Key characteristics	Key considerations
	Case: Bilateral lending in preparation for a bond for the expansion of a cement plant operating in Central America.	Unit of analysis: The company’s cement asset in Central America (see fig 2 (a))
1. Proximity to human rights (HR) impacts	Allegations of HR abuses at the company site, lack of intervention from the Government with regard to the project being in contravention of Convention 169 (Indigenous Peoples and Tribal Peoples Convention).	<i>Direct linkage with high level of proximity</i> because of asset specific finance
2. Due Diligence (DD)	DD is scaled according to the underlying human rights related risk. The project is a high profile development in Central America which has attracted the scrutiny of several international organizations, including the United Nations Special Rapporteur on the Rights of Indigenous Peoples. The bank has identified social and environmental risks to be reviewed further and the DD is weeks away from completion.	Asset specific / HR specific
3. Leverage	The bank has a relatively new relationship with the client, and by being involved in the future public transaction the bank has a good opportunity to exert its influence on the client. However, an initial DD showed that the issues are systemic and related to the government; therefore the bank (and the client) has no direct influence. In addition, the tight timeline of the transaction does not allow the bank to discuss potential mitigation measures.	Medium to low
<b>Outcome (for bank)</b>		
4. Decision-making	The issues are systemic rather than poor corporate management. The bank decides not to take the risk as prevention and mitigation is not within the area of influence of the client, nor the timescales available to the transaction.	Decline to participate in the transaction
<b>Outcome (for rights holder)</b>		
5. Actual HR Impact	The HR impacts have not been mitigated, nor has a grievance mechanism been introduced following the bank’s decision to exit the transaction.  The bank’s decision does not influence the actions of the client with regard to rights holders.	High adverse impact

#### 4. Case study #4

A bank is the co-Arranger for a **bond issuance** of an **electronic company** based in Asia Pacific, which is facing allegations of forced labor and unfair working conditions in its supply chain. Following an initial assessment of the allegations as well as the information disclosed by the Company (e.g. sustainability report), the bank decides the transaction warrants further due diligence. Following a request for further information by the bank, the client decides to exclude the bank from the transaction and avoid further diligence around its supply chain activities.

Case study 4	Key characteristics	Key considerations
	Case: Bond issuance for General Corporate Purposes (GCP).	Unit of analysis: The company at corporate level (see fig 2 (c) or (d))
1. Proximity to human rights (HR) impacts	Allegations of forced labour and unfair working conditions at some of the company's sites and in its supply chain.	<i>Direct linkage with low level of proximity</i> due to the GCP nature of the bond
2. Due Diligence (DD)	DD is scaled according to the underlying human rights related risk. The company has attracted the scrutiny of several international organizations and media. The bank has identified social and environmental risks and asks tailored questions as part of the DD process.	Corporate level / High risk company profile
3. Leverage	The bank leverage is low given both the type of product and the fact that other banks involved in the transaction did not request further information.	Low
<b>Outcome (for bank)</b>		
4. Decision Making	The client decides to exclude only the bank that asked additional questions on the company's labour practices. The bank has followed a thorough process.	The bank is excluded from participating in the financing
<b>Outcome (for rights holder)</b>		
5. Actual HR Impact	It is likely that the impacts have remained highly adverse. The bank will not know whether the human rights impacts have been mitigated, or whether the rights holders will have access to remedy.	High adverse impact

## 5. Case study #5

**Bond issuance** for an Asia-Pacific chemical company. The client had previously encountered protests by hundreds of residents who were worried about the alleged pollution caused by chemical production.

Case study 5	Key characteristics	Key considerations
	Case: Bond issuance for general corporate purposes (GCP).	Unit of analysis: The company (see fig 2. (c) or (d))
1. Proximity to human rights (HR) impacts	Social / community conflicts associated with the company's activity (residents expressing concern about toxic chemical production in one of the company's centres in China).	<i>Direct linkage with low level of proximity</i> due to the GCP nature of the transaction
2. Due Diligence (DD)	Review of publicly available information and participation in the DD to get a better understanding of the client's policies and procedures, and access to remedy provision, to manage potential human rights issues as well as to better understand its position with regard to the allegations. The DD reveals that the allegations were not well founded and that the company had already undertaken remedial actions.	Corporate level / High risk name
3. Leverage	Low leverage considering the weak relationship between the bank and the company (as a bond where the bank is only involved in initial underwriting and no longer term duration of relationship) combined with the general corporate purpose of the transaction.	Low
<b>Outcome (for bank)</b>		
4. Decision Making	The bank approves the transaction based on the positive finding from the DD and based on the client's commitment to improve its disclosure around remedial actions.	Approved
<b>Outcome (for rights holder)</b>		
5. Actual HR Impact	Due to the nature of the transaction and the weak relationship, the bank has no ability to monitor the implementation of the company's commitments post transactions. However, should future transactions with the client occur, and/or the relationship strengthening, the bank will continue to monitor the client's performance.	Medium adverse impact

## 6. Case study #6

**Buy-side advisory** role for a US food company on its proposed acquisition of another US-based company. The US food company is the subsidiary of an Asian food company that has attracted extensive negative media coverage due to allegations of slavery and labour issues in its supply chain.

Case study 6	Key characteristics	Key considerations
	Case: Advisory role for a US food company, the parent of which is based in Asia and faces serious human rights allegations in its supply chain.	Unit of analysis: The US subsidiary (See fig 2. (f)) However information is requested at parent level
1. Proximity to human rights (HR) impacts	Labour and working condition issues associated with the parent company's supply chain activities in Asia. Some activists called for a consumer boycott against the parent company.	No link
2. Due Diligence (DD)	<p>As part of the DD for this transaction, the bank requested further information from its client, the US food company, who provided additional documentation on the actions taken at parent level to address the above labor allegations.</p> <p>Following DD, the bank concluded that the client has taken the right measures to address the potential for labor issues in its supply chain – including a Human Rights policy covering the company's supply chain and actions to promote sustainable practices among its suppliers, and the introduction of a grievance mechanism. The company also committed to improving social practices at industry level through the participation in a sustainable fisheries roundtable.</p>	Issue specific, corporate level
3. Leverage	Although the advisory role to the subsidiary provided a limited leverage to the bank, the severity of the allegations and the client relationship with the subsidiary allowed a thorough diligence and engagement at the parent level.	Medium to high based on subsidiary relationship
<b>Outcome (for bank)</b>		
4. Decision Making	<p>The bank was satisfied with the outcome of the DD and the client's commitment and capacity to manage the impacts.</p> <p>As a consequence of this transaction, the bank expanded the current DD process to include the fishery sector in which the parent company is involved</p>	<p>Approved</p> <p>Enhanced diligence process relative to the sector</p>
<b>Outcome (for rights holder)</b>		
5. Actual HR Impact	Due to the nature of the transaction, the bank has very limited ability to monitor the implementation of company's mitigation measures post transaction. However, should issues arise again, considering the relationship, the bank will seek to engage with the client even outside a transaction context.	Unknown



## 7. Case study #7

A bank has a credit exposure with an infrastructure company due to a **loan for general corporate purpose (GCP)** provided in the past. The duration (tenor) of the GCP credit facility is extended for a few years but not increased in amount (i.e. there is no money flowing due to the tenor extension) after the company has acquired a company that is involved in activities where there are alleged severe human rights abuses. The bank did not advise on or finance the acquisition; the client has publicly said that it will exit the contract to run such operations as soon as the contract with the local government expires. Although there is no link with the human rights violations, the bank engages with the client to gather more information and better understand its client's commitment to respect human rights.

Case study 7	Key characteristics	Key considerations
	Case: Tenor extension for a previous loan for GCP (no underlying transaction because no flow of money associated with the extension).	Unit of analysis: The company. (see fig 2 (f)) <sup>11</sup>
1. Proximity to human rights (HR) impacts	Severe allegations of human rights abuses at the operations that have recently been acquired by the client.	No link
2. Due Diligence (DD)	Despite no underlying transaction (i.e. no money flowing), the bank decided to engage with the client and perform DD to better understand the client's commitment to mitigate such impacts. An NGO report and media attention increases the pressure on the client and the bank.	Corporate level / asset specific
3. Leverage	Low leverage considering no underlying transaction. The client has a strong human rights policy and no negative track record. The client has publicly confirmed that it will not renew the contract to run the operations upon expiration of the contract. The bank engages with the client with whom it has a business relationship and perform its DD, encouraging the client to disclose more information about the situation.	Low
<b>Outcome (for bank)</b>		
4. Decision Making	The banks will continue to monitor the situation and will continue to engage with the client.	Maintain the relationship
<b>Outcome (for rights holder)</b>		
5. Actual HR Impact	The HR impact has not been mitigated and action from the local government is needed to protect the rights holder.	High adverse impact

<sup>11</sup> Because the new transaction is an extension of the duration of the original loan, but not an increase in size/amount, the unit of analysis remains the company at the time the loan was originally issued. At that time the asset/subsidiary where the human rights impacts are occurring, were not part of the company. If we add the **temporal** dimension, it could be – as represented in Figure 2 (f) – assumed that the company has now expanded and has two subsidiaries, one being the original company that the loan was issued to, the other being the newly acquired subsidiary. As such, there is no link between the loan to the company at the time pre-acquisition and the negative human rights impact associated with the new subsidiary of the company.

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