December 4, 2017

Barbara Bijelic
Legal Expert, Responsible Business Conduct Unit
Organization for Economic Co-operation & Development
Sent by email to: Barbara.bijelic@oecd.org

Re: OECD Due Diligence Guidance for Responsible Business Conduct for Financial Service Providers

Dear Ms. Bijelic:

We, the undersigned investors, write today to share our preliminary thoughts on key considerations for the upcoming work on defining responsible business conduct in the context of Financial Service Providers and corporate lending transactions. We welcome the OECD's attention to this timely and important aspect of the financial system and appreciate the opportunity to provide our input.

As investors, we are exploring the concept of responsible business conduct for investors as outlined in the OECD publication *Responsible business conduct for institutional investors: Key considerations for due diligence under the OECD Guidelines for Multinational Enterprises*.[1] Accordingly, we are taking steps to understand if we are applying appropriate due diligence to prevent or address negative impacts on human and labour rights, the environment, and corruption in our investment portfolios. We are particularly concerned with addressing impacts related to investee companies that are causing, contributing or directly linked to human rights impacts.

Investor due diligence reliant on investee company due diligence

Investors will rely on the due diligence efforts of portfolio companies in order to inform their own actions. In effect, in order for investors to practice proper due diligence (in regard to investee entities involved in corporate lending) a necessary prerequisite will be to ensure that corporate lenders have a similar process in place. Evidence of a robust due diligence process – and the results of that process – will allow investors to determine their own exposure to adverse impacts and more importantly to determine if the adverse impacts are being adequately mitigated or avoided by the investee company. Deciding on the proper course of action (e.g. engagement, collaboration, divestment, etc.) to address actual or potential adverse impacts in investor portfolios will be greatly influenced by investee company actions and disclosure.

[1] https://mneguidelines.oecd.org/RBC-for-Institutional-Investors.pdf

Lack of disclosure a significant impediment for investors

We are aware that some corporate lenders are already utilizing relatively sophisticated due diligence processes to mitigate the risk of contributing to adverse impacts through their lending. However, current disclosure, even by some leading companies which we believe to be practicing effective due diligence, is not adequate for investor needs.

The lack of adequate disclosure was demonstrated by the Shift report *Human Rights Reporting: Are companies telling investors what they need to know?*, which examined the maturity of the human rights reporting of 74 companies, including 20 from the financial services sector.[2] Key findings included a lack of oversight among the companies (45%), a lack of clarity about internal controls (90%) and in some cases no information at all on the governance of human rights (16%).

Almost 100 investors with close to $5 trillion in assets under management support the UN Guiding Principles Reporting Framework, stating that meaningful disclosure of human rights performance can play a significant role in reducing a company's human rights risks, can contribute to a company's competitive advantage, and can strengthen its long-term financial stability by:

- Cultivating heightened internal attention to policies, processes, and practices to proactively manage and embed respect for human rights
- Providing greater access to business opportunities with governments, business customers, and buyers who recognize the reduced risks to themselves
- Improving relationships with key external stakeholders and securing a stronger license to operate
- Improving the ability to preserve reputation when negative impacts occur
- Providing a comparative advantage, with a growing number of stock exchanges scrutinizing companies' non-financial performance, including human rights performance

As the OECD advisory group develops the guidance for responsible business conduct in corporate lending, we recommend that effective disclosure of due diligence processes and outcomes be a key component. We note that the guidance for institutional investors rightly emphasizes the "show" of "knowing and showing" as a key accountability mechanism.[3] We believe a similarly rigorous expectation is required of financial service actors involved in corporate lending.

Directly linked or contributing to human rights impacts

A key distinction in the UN Guiding Principles on Business and Human Rights (embedded in the OECD expectations) is whether a corporate entity is causing or contributing to adverse impacts on human rights or whether it is instead directly linked to adverse impacts (or not linked at all). The distinction is clearly important as there are different expectations of the corporate entity depending on its

[2] https://www.shiftproject.org/media/resources/docs/Shift_MaturityofHumanRightsReporting_May2017.pdf

[3] Section 2.4, page 43: *Responsible business conduct for institutional investors: Key considerations for due diligence under the OECD Guidelines for Multinational Enterprises*

relationship with the adverse impact. We are aware that it has been suggested that banks can generally only cause or contribute to an adverse impact if the impact is occurring through the bank's own activities, which are seen as separate from the bank's corporate lending activities and other types of client relationships. In the context of banks' business relationships with clients, the argument has been advanced that banks can only be more or less strongly "directly linked" to the impact depending on the architecture of the loan.[4] These debates are continuing and we imagine that they will be a key component of the advisory group's deliberations. We have the following thoughts to offer on the subject.

We believe a corporate lender's relationship to an adverse impact should be determined at least in part by the quality of its due diligence actions, rather than being fixed in advance by the architecture of the loan. For example, if a corporate lender resolutely refused to respond to the severe human rights impacts of a lending client, despite strong evidence of the borrower causing or contributing to human rights violations, failing to exercise any leverage with the client could be construed as contributing to the violation, or at the very least as official ambivalence. And if other stakeholders (including other lenders) were attempting to use their leverage to improve the situation the lender's perceived ambivalence could actually undermine their actions. Such a perception could lead to the adverse impact continuing or even getting worse. We suggest this abrogation of the responsibility to conduct due diligence could potentially move the lender's relationship with the adverse impact from "directly linked" to "contributing".

Conversely, if a lender had done its due diligence, and taken steps to mitigate the impacts (say through engaging the client on its own due diligence obligations) then it is more likely to correctly be categorized as "directly linked" to the impacts, and by showing its due diligence steps could likewise provide reassurance to its investors who would be doing their own due diligence on the matter.

We believe this interpretation reflects the intent of the UNGPs, which is to incentivize the active mitigation of adverse human rights impacts by business. By acknowledging that the categorization of a lender's relationship to an adverse impact as "contributing to" or being "directly linked" to the impact may vary depending on whether or not appropriate due diligence activities have been undertaken, the advisory group should provide guidance to lenders that honours the explicit aim of the Guiding Principles.

In regard to what constitutes proper due diligence, we understand that this will be a key focus of the working group's deliberations but we do have some initial thoughts. The context of proper due diligence will vary based on the specific situation. In some instances, the lender will be able to rely on the various assessments (e.g. environmental, social, human rights) provided by the client in order to meet its due diligence requirements. In other instances there will be a need to directly engage third parties to perform an assessment on behalf of the lender (or lenders). However, the one constant that must be in place for effective due diligence to occur is that lenders must have adequate internal capacity (i.e.

[4] *Conference Report of the Thun Group of Banks Annual Meeting on 19 June 2017.* https://business-humanrights.org/sites/default/files/documents/2017_Thun%20Group%20meeting_report.pdf

expertise) in order to place the information available to them into proper context. Ultimately the lenders cannot outsource their own responsibility for due diligence.

Scope of the guidance

In regard to the question of scope, we believe that the priority for the guidance should be project and corporate finance activities, but corporate bonds should also be considered as more investors look to invest in impact and green finance bonds (which could have unintended human rights consequences). For example, there has been enhanced scrutiny by investors of the labor and community impacts of some solar and wind projects.

In regard to project finance, we believe the advisory group should align its activities with the recently announced intention of the Equator Principles Association to revisit the Equator Principles framework, which includes an explicit focus on human rights.[5] There will clearly be some overlap in the two mandates and in a situation where there are limited resources care should be taken to ensure the same work is not done twice. However, recent experience in North America, as illustrated by the controversy associated with the Dakota Access Pipeline (DAPL) and other pipeline projects, has shown that project finance is clearly relevant for discussion of responsible business conduct of financial institutions in the context of the OECD Guidelines. Moreover, as in the case of the Dutch Banking Agreement, the OECD advisory group can bring a critical multi-stakeholder perspective to bear on this important topic.[6]

In regard to corporate finance, we believe the precedent that has already been established by the OECD in regard to institutional shareholders – that even minority shareholders can be directly linked and there is an expectation to undertake due diligence – dictates that the advisory group should consider corporate finance activities. Corporate lenders, in the main, have a greater potential to influence the corporation than a minority shareholder could possibly aspire to. To prove the point, consider the ramifications of a corporate lender rescinding or choosing not to extend its line of credit versus an investor selling its shares (to another investor). As such, we believe that corporate finance activities should be in scope for this exercise.

In conclusion, we thank you for the opportunity to share our investor perspective and hope you find it useful. The undersigned investors would be happy to discuss any of the issues raised in this letter further. We look forward to further engagement with the advisory group as it progresses its mandate.

[5] http://www.equator-principles.com/

[6] https://www.ser.nl/~/media/files/internet/publicaties/overige/2010_2019/2016/dutch-banking-sector-agreement.ashx

Signed,

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