USING **LEVERAGE** WITH CLIENTS TO DRIVE BETTER OUTCOMES FOR PEOPLE

6 TAKEAWAYS FROM OUR FIRST FINANCIAL INSTITUTIONS PRACTITIONERS CIRCLE IN 2021 *(AND A LIST OF ACTIONS YOU CAN PUT IN PRACTICE)*

Shift

FINANCIAL INSTITUTIONS
PRACTITIONERS CIRCLE

In March 2021, Shift held the first peer-learning session of its Financial Institutions Practitioners Circle, focusing on the topic of leverage. This resource captures the key takeaways of the session.

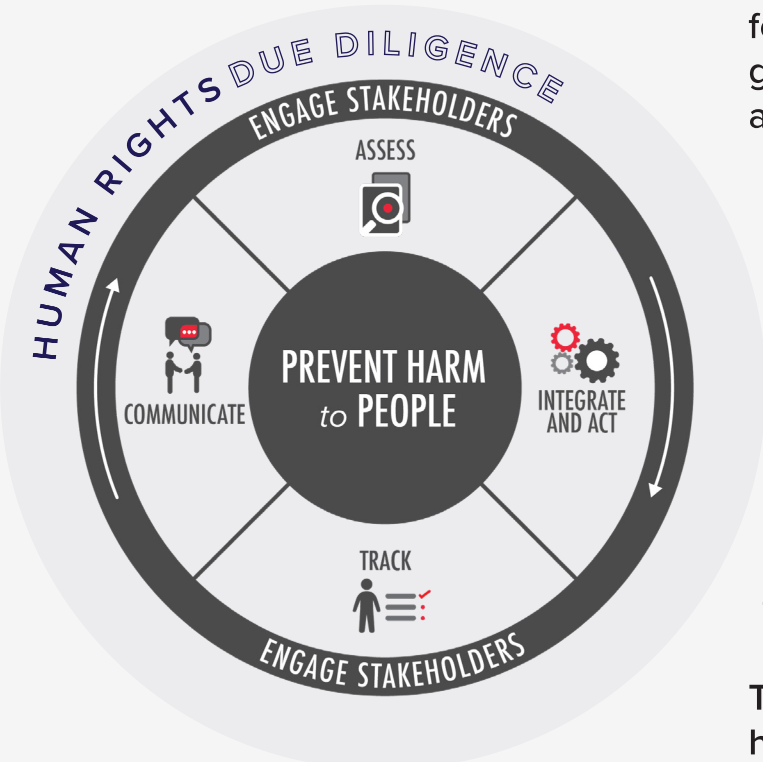
The traditional approach of many banks and Export Credit Agencies (together "FIs") has been to assess risk from a credit risk perspective and to make a **binary** decision about whether or not they will enter into commercial relationship with a client. As such, too often those decisions have been made on the basis of **risk appetite** rather than considering the more complex task of **risk management**, engagement with the client and the application of firm sustainability expectations. More committed FIs are shifting towards an approach that emphasizes **managing risks to affected stakeholders** rather than a sole focus on managing potential reputational risks.
In addition to setting human rights-related expectations of clients upfront, FIs now need to focus, for higher risk sections of the portfolio, on scrutinizing the **appropriateness** of the expectations against intended outcomes, **reviewing client adherence** to them and **evaluating their impact**.

When FIs take this approach, we see greater alignment with the UN Guiding Principles' focus on improving outcomes for people. Moreover it facilitates a move away from so-called "cut and run" approaches whereby the bank makes another binary decision to cut ties with clients amid reputational concerns without first attempting to use leverage.

WHAT IS LEVERAGE?

Leverage refers to the ability of a business enterprise to effect change in the wrongful practices of another party that is causing or contributing to an adverse human rights impact.

Source: OHCHR
See further from Shift here.



Due Diligence is a wheel after all: it doesn't start and end at assessment. The bank has a responsibility to get to **action**: to use its influence (leverage) to seek to improve outcomes for adversely affected people, including, at a minimum, engagement with clients around risks. This also helps the bank to get to the "yes, and" approach to navigating higher-risk transactions, whereby the bank can more confidently take on clients or transactions that pose heightened social risk, **if** it is prepared to invest the resources necessary for leverage **and** it has a credible road map for where the client needs to get to in terms of maturity of approach and/or concrete Key Performance Indicators (KPIs). It goes without saying that an element of pragmatism needs to be brought to bear when looking to achieve this at a portfolio level. The prioritization of resources and focus at the assessment phase is particularly important for financial institutions given their challenge of scale.

The FI's responsibility to respect human rights includes the need to understand where it has leverage – in the multiple different forms of leverage available – and where it needs to build it; it means using this leverage to seek to prevent and address harm in order to justify continued engagement. Leading FIs are increasingly exploring and institutionalizing this process. **(See Practice Example on page 8).**

Here are our **6 key takeaways** from our discussion about how to consider leverage for financial institutions from the perspective of the UNGPs, with practical steps that might help turn these insights into action.

1 REPOSITIONING ENGAGEMENT WITH CLIENTS: from "sorry to bother you" to "you're welcome."

Getting to **better outcomes for people** needs to be the objective when an FI is connected through clients to severe human rights risks. This is one of the key innovations of the UNGPs and what keeps our actions anchored to actually improving the lives of the most vulnerable. Conversely, from a very practical perspective, financial materiality matters to many inside banks. But these two facts needn't be in opposition: there is enough data available now to show internal stakeholders, (who may push back against attempts to "bother" their client with further questions or worry about driving clients away), clients and investees, that a robust focus on mitigating salient impacts on people creates, on the whole, **more resilient companies** (read this paper to learn more). As such, leading banks are engaging clients from the perspective of **adding value through expertise** on key social issues.

TO DO

Explore the extent to which we can expand the buy-in for more action on human rights – internally and externally – by highlighting that leverage can be about **bringing value** to clients, rather than (only) the extent to which FIs can strongarm them into action. Rather than framing engagement with clients as potential nuisance at best, or a risk of them seeking funds elsewhere, explore how to frame engagement as a **business enabler**.

LEVERAGE FOR WHAT?

Making better asks.

2

If the purpose of the use of leverage is to improve outcomes for people, are the types of actions that FIs are asking their clients to take, as part of their exercise of leverage, **really achieving that end**? Shift has written extensively about the challenge of many of the "S" indicators in evaluation: too often, for example, the **existence** of a policy or mechanism is taken as an indicator of maturity, without any consideration of its **quality** or of how that policy will lead to tangible changes in behaviors or practices. The same challenge applies when such indicators are used as "asks" by banks in leverage efforts: requiring a client to write a policy or set up a grievance mechanism can lead to wildly different quality in practice. At the same time, capacity limitations within the bank can undermine the impact and authenticity of leverage if expectations are set that cannot be monitored or data is being asked for that banks have no ability to process.

TO DO

Take a critical lens to client expectations, through sector policies to the highest intensity engagements, and interrogate whether the "asks" we are making of clients are **actually likely to lead to better outcomes for people**. If they are not, **reformulate them**, starting with the outcomes for people we want to achieve, and then assess whether our "asks" of clients are getting us there.[1] **Connect our asks to salience**, so that we are laser-focused on making asks that align with the most severe, potential impacts with which we may be involved through our portfolio.

1 Shift's Indicator Design Tool may be helpful in generating smarter questions of clients, and to construct the narrative behind the use of leverage for an internal audience. Other Shift tools that may be useful in this context include the "Signals of Seriousness for HRDD" and "Leadership and Governance Indicators of Rights-Respecting Practice."

3

FRONT-LOADING for leverage.

If the most salient human rights issues with which banking clients are grappling today have shown us anything, it's that scrambling to identify and build leverage after a crisis has emerged can be incredibly difficult. Why leave it that late? Leverage can be front-loaded into onboarding, assessment and decision-making processes. Again, this can be a **business enabler**: it can support the FI in going ahead with a transaction/ relationship, by ensuring there is leverage available commensurate to the severity of the risk.

TO DO

Assess your leverage with a client or in a transaction as part of your risk assessment process for higher risk transactions. A set of diagnostic questions can assist the FI to determine a) whether it will likely be able to influence the client to take appropriate action in the event an adverse impact and b) what steps the FI could take to build more leverage. (See Practice Example on page 8).

ENSURING ACCOUNTABILITY for leverage efforts.

4

We know that leverage often takes time. Yet, leverage can never be a “blank check” for moving forward with high-risk transactions. Banks can do a better job of holding themselves accountable for leverage efforts. This means identifying how likely it is that the change banks are asking for will lead to better outcomes for people, and tracking the role the bank’s leverage played (or may have played) in changing client behavior.

TO DO

At a minimum, where the client makes a change, ask them about the drivers. Consider tools for designing and following a theory of change with higher risk clients. At the cutting edge, leading FIs are embedding **templates for leverage accountability**. (See Practice Example on page 8).

5 INTERNAL LEVERAGE FOR EXTERNAL LEVERAGE: Building and harnessing a mandate within the FI.

Internal sustainability champions within FIs need to be "**aggressively opportunistic**" in identifying potential mandates for steering their institution towards more mature approaches to leverage. But a mandate is not created from ad hoc opportunity alone: leading practitioners are working hard to sculpt actionable mandates and turn challenges into opportunities to catalyze improvement within the bank. Triggers for mandates identified by practitioners:

CATALYST	EFFECT	AT THE SAME TIME...
LEGISLATION	Some banks have experienced increased buy-in on specific human rights topics following legislation, such as the UK Modern Slavery Act.	in a highly regulated sector prospective legislation has not always created the internal traction some practitioners had expected.
FINANCIAL LOSSES	Losses from connection to rights-related impacts can be difficult to quantify, but where convincing efforts are made to present these, they can have a catalytic effect internally.	practitioners note that internal communications should be underpinned by a robust analysis of the financial impact, which is harder in some cases to quantify.
CIVIL SOCIETY CAMPAIGNS	Campaigns can be effective at creating a mandate for further action, particularly where there is a wide-reaching media campaign.	practitioners exercise care in ensuring that efforts to invoke these campaigns internally accurately reflect the nuances of the situation and incorporate appropriate expertise to ensure actions lead to better outcomes for people.
CLIMATE CHANGE EFFORTS	Climate change is dominating sustainability discourse within banks and some practitioners are leveraging this engagement to shine a spotlight on social impacts that are connected to climate change, as well as social issues that can be positioned as undermining the just transition.	practitioners take care to ensure that quantitative approaches do not bleed unduly into the S space.
STRONG LEADERSHIP FROM THE TOP	Pressure from shareholders allows sustainability practitioners a persuasive reference point in internal conversations with gate keepers.	some shareholders do focus on short-term profit rather than the responsible / sustainable option.

TO DO

Remain vigilant in **identifying opportunities** for embedding a more mature approach to leverage and be prepared with a strategy to **harness a mandate** when it presents itself. Record and **highlight examples** when leverage has had some success.

PRACTICE **EXAMPLE**

In this edition we feature a practice example from **Export Development Canada (EDC)**, a member of the FIs Circle and with whom Shift has been collaborating to develop and implement a framework for leverage and remedy. It includes policy commitments on leverage and remedy (EDC's Human Rights Policy), Principles for Leverage and Remedy, a suite of transactional due diligence tools and (up-coming) portfolio-level strategies for areas requiring attention on leverage and remedy. EDC's Principles for Leverage and Remedy, have synergies, at a policy level, with several of the take-aways above. For example:

- EDC Principle 4 on "Value-add for Customers" serves as a way to reposition their engagement with clients (Take-away #1)
- EDC Principle 9 on "Assessing Leverage" focuses on the importance of assessing leverage up-front to inform decision-making (Take-away #3)
- EDC Principle 7 on "Accountability and Principle 8 on "Transparency" commits EDC to be held accountable for its actions (Take-away #4)

At our FIs Circle workshop, EDC shared with FIs Circle Members the mandate for and details of their innovative approach to leverage and remedy. EDC also described the framework for operationalizing these policy commitments into a systematic, organization-wide practice, supported by engagement at all levels of the organization, and a dedicated change management process.

6

"WE ARE THE ONLY ONES ASKING": leveling the playing field for leaders.

When talking with FIs about leverage with clients, if we had to select one phrase we hear more than any other from leading FIs practitioners, it would be "**we are the only ones asking the [human rights] questions**." FIs practitioners are, in turn, hearing this from relationship managers, and it is clear that this perception undermines internal buy-in. As we seek to address this issue, we need to wrestle with several challenges, including the following:

- The lack of sector-wide alignment on human rights expectations of corporate clients (outside of project finance);
- A compliance mindset and [perceptions of] legal and contractual barriers
- Self-perception that greater action on social impacts would render the bank uncompetitive.

There is clearly an opportunity presented by initiatives based on common commitments, particularly at the sector level, which can provide a clear standard around which FIs can align and an opportunity for collective leverage.

Regulatory drivers can provide a mandate **within clients** aligned with the expectations of leading FIs, and can **enhance disclosure by clients/investees** to allow FIs to better evaluate performance and devise leverage strategies.[2]

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2 In our final session of the March workshop, Shift provided background and updates on the EU process towards mandatory human rights & environmental due diligence, as well as the EFRAG task force, and reflected on alignment with the UNGPs, including, e.g. ideas for addressing the accountability gap between the potential scope of liability under new legislation, and the responsibility to carry out HRDD pursuant to the UNGPs.

TO DO

Explore and engage with industry initiatives or regulatory processes from the perspective of the opportunities presented to level the playing field and improve outcomes for people.[3]

MOVING FORWARD

The next session of Shift's Financial Institutions Practitioners will focus on **remedy**, a topic closely linked, of course, with leverage and regarding which the financial institutions space is seeing considerable momentum.

3 See, e.g. ABN Amro's discussion of EU legislation in its Human Rights Report 2020.

Using Leverage with Clients to Drive Better Outcomes for People
Shift, New York. July 2021

ACKNOWLEDGMENTS
This resource was authored by Ashleigh Owens, with valuable input from David Kovick.

Design by Julia Ferragamo.

ABOUT **SHIFT**

Shift is the leading center of expertise on the UN Guiding Principles on Business and Human Rights. Shift's global team of experts works across all continents and sectors to challenge assumptions, push boundaries and redefine corporate practice in order to build a world where business gets done with respect for people's dignity. We are a non profit, mission-driven organization headquartered in New York City.

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ABOUT **SHIFT'S FINANCIAL INSTITUTIONS PRACTITIONERS CIRCLE**

It has been clear to Shift and the practitioners in banks that we work with that there has been a need to create a space for financial institutions (FIs) to come together and candidly discuss key challenges and opportunities in UNGPs implementation, facilitated by human rights experts. We envisaged a space in which we could both a) bring to the discussions the common challenges we have seen in our bilateral work with financial institutions, and b) be responsive to the issues banks wanted to bring to the table as they seek to embed their responsibility to respect rights. This was realized in March this year with our first FIs Circle peer learning session, at which banks, export credit agencies (ECAs) and Shift sat around the virtual table and shared and scrutinized current and cutting-edge practice when it comes to lending and leverage.

To learn more visit: shiftproject.org/fiscircle/ or contact us at: info@shiftproject.org.