

FINANCIAL INSTITUTIONS AND REMEDY: MYTHS AND MISCONCEPTIONS

The background of the entire page is a dark, textured surface, possibly wood or stone. Scattered across this surface are several paper boats. Most are a light teal or blue color, while one boat in the upper right quadrant is a bright yellow-orange. The boats are arranged in a way that suggests they are floating or have been tossed onto the surface.

Shift

FINANCIAL INSTITUTIONS
PRACTITIONERS CIRCLE

YEAR 1
FALL SESSION

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

It can be difficult for sustainability practitioners within financial institutions (FIs) to engage the institution on the third pillar of the UNGPs: Remedy. But engage them they must. There remains an enduring “remedy gap”: in too many cases, remedy is not available for people who are harmed by business activities, which financial institutions may be involved with in some way via their products and services. In this paper, we explore possible factors that contribute to this challenge: **5 persistent myths about FIs and remedy** that may cause internal blockages and get in the way of achieving better outcomes for people. We address each of these myths in turn and offer insights into emerging good practices as well as some initial steps that FIs can take to move in the right direction.

This paper draws from Shift’s experience working bilaterally with financial institutions, and from discussions in Shift’s FIs Practitioners Circle.

MYTH ONE

GOOD HRDD WILL KEEP US FROM EVER BEING INVOLVED WITH NEGATIVE IMPACTS

Fls know that good risk management does not eliminate all risks to people. The UNGPs also recognize the unfortunate reality that impacts can occur despite the best efforts of enterprises, including financial institutions, at Human Rights Due Diligence (HRDD).¹ When impacts do occur, Fls can play a critical role in enabling access to remedy – including as part of seeking to use their leverage with clients where clients are the ones responsible for providing remedy. Establishing processes to understand and strengthen the remedy ecosystem isn't an admission of failure – in fact it **demonstrates** respect for rights, as it represents, in the words of the OHCHR, an “intent to ensure that respect for human rights is restored as swiftly and effectively as possible should this happen.”²

DEFINE: REMEDY ECOSYSTEM

A remedy eco-system approach recognizes that getting to remedy in many cases will require a range of actors to play different but complementary roles. It's not about shifting responsibility: rather, it's an integral part of meeting Fls' responsibility by thinking about how they can use their leverage differently to enable remedy in practice. The ecosystem framing brings a focus to preparedness for remedy, including by strengthening the broader grievance system architecture before impacts occur. After impacts occur, it includes using leverage to influence others to provide remedy. The choice of roles and specific actions will be shaped by the nature of the financial institution's involvement with the impact (i.e., cause, contribution or linkage).

¹ OHCHR Interpretive Guide, p. 63.

² OHCHR Interpretive Guide, above.

EMERGING GOOD PRACTICES

Leading practice involves designing processes with a reluctant but firm acknowledgment that all impacts will not be prevented. Some banks are creating their **own** grievance mechanisms; others are mapping the **remedy ecosystem** for certain sectors, sub-sectors or regions; and leading FIs are assessing and enhancing higher-risk clients' "**preparedness for remedy**," i.e. the extent to which clients are prepared to provide remedy to affected stakeholders for impacts the client might cause or contribute to (see further below).

TAKING A STEP IN THIS DIRECTION

SOCIALIZE internally the importance of robustly anticipating and proactively preventing and managing risks. At the same time – and in no way in contradiction to this – socialize the concept of preparedness for remedy within the institution.

EXAMINE the institution's current process for preparedness for remedy: the extent to which the bank is ready to engage constructively when impacts occur, both internally as well as externally with clients and other parties (including stakeholders), on steps the responsible parties will need to take to ensure stakeholders have access to remedy.

MYTH TWO

FIS CAN'T DO ANYTHING ABOUT REMEDY UNTIL AFTER IMPACTS OCCUR

In the first publication of our FIs Practitioners Circle, which focused on leverage, we spoke about the importance and benefit of thinking about leverage **early** in client relationships and transactions to avoid a “scramble” once impacts have occurred. The same applies to remedy. If we recognize that remedy may indeed need to be provided by clients or banks, we can place more effort into **front-loading** preparedness for remedy. In too many cases, when businesses are involved with negative impacts, they are not well equipped to provide remedy.



They may lack an understanding of the responsibility, sufficient internal commitment, the capacity or a combination of these factors. FIs should assess clients' **preparedness for remedy** at the outset of a transaction and look to strengthen it through leverage, including by helping clients start **thinking about remedy early**, before impacts occur.

EMERGING GOOD PRACTICES

Leading FIs are building out toolkits for institutionalizing processes within the FI to a) assess client preparedness for remedy up front and b) build the FI's leverage for remedy – both before and after impacts occur.

TAKING A STEP IN THIS DIRECTION

TAKE a higher risk slice of the portfolio and the salient issues (most severe, actual and potential impacts on people) you have identified.

EXPLORE the options for remedy for the stakeholders who could be impacted in this way.

CONSIDER your confidence in the client's ability to provide or contribute to remedy. How can the institution use its leverage to increase the client's preparedness for remedy? To strengthen the remedy ecosystem?

<div> <div>MYTH</div> <div>THREE</div> </div>	A) FINANCIAL INSTITUTIONS WILL <u>NEVER</u> CAUSE OR CONTRIBUTE TO IMPACTS IN THEIR PORTFOLIOS
	B) FINANCIAL INSTITUTIONS WILL <u>ALWAYS</u> HAVE CAUSED OR CONTRIBUTED TO IMPACTS IN THEIR PORTFOLIOS

There has been much discussion – now settled – about whether a financial institution can **contribute** to impacts caused by the clients it finances: it can. Involvement with harm to harm has been such a hot topic for FIs as the responsibility to **provide** remedy is triggered where the FI **causes** or **contributes** to an impact. For FIs that have credible Environmental and Social Risk Management (ESRM) systems in place that pay attention to human rights risks, it is fair to say that an impact to which an FI is involved through their portfolio companies **often** constitutes a situation of linkage – but again, this is certainly not always the case. It is essential for the credibility of the FI that it **undertakes an analysis** of its involvement with the impact and asks itself the hard questions **before** determining the action it will take on impacts that have occurred.

The good news for FIs is that they control how they are involved with impacts: the quality of HRDD the FI has undertaken plays a critical role in determining its involvement with the harm. The OHCHR³ and the OECD⁴ have recognized a factor-based approach to determining where an institution sits on the continuum between contribution and leverage, based on the quality of its due diligence processes. The Dutch Banking Sector Agreement⁵ also incorporated this analysis. As such, clarity on what constitutes quality due diligence becomes even more critical, which Shift has sought to address in its Signals of Seriousness for Human Rights Due Diligence.

3 https://www.ohchr.org/Documents/Issues/TransCorporations/WG_BHR_letter_Thun_Group.pdf

4 See hyperlink at **Question 29, page 70**.

5 See hyperlink at **5.3, page 36**.

EMERGING GOOD PRACTICES

A number of leading financial institutions are developing specific diagnostic tools to determine connection to impacts, including ECAs, DFIs, private commercial banks, and industry groups. These tools, which structure the analysis around the quality of HRDD that was undertaken by the FI, are being embedded into grievance mechanisms and/or process steps that are triggered once the FI is made aware of an impact associated with its portfolio. This type of diagnostic tool can also inform quality HRDD for higher-risk transactions. At the cutting edge, FIs are considering processes to **share the analysis with stakeholders** and to **accept their input** into the analysis.

TAKING A STEP IN THIS DIRECTION

BUILD capacity internally on the subject of involvement with harm, and specifically how this applies to financiers, using the linked materials above.

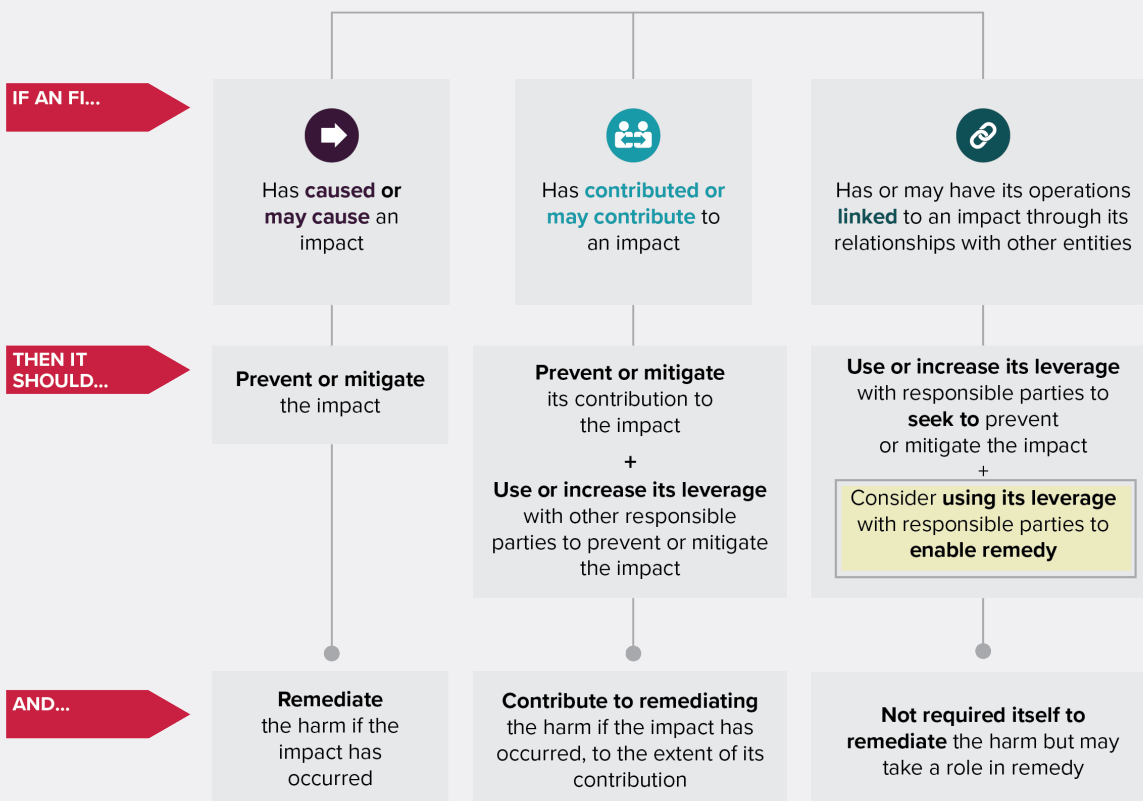
SEEK to move internal perspectives away from the assumption that all portfolio impacts are solely the clients' responsibility and rather socialize an understanding that if abuses do occur where they could not reasonably have been foreseen, the FI's stakeholders will assess it on its response: how well and how swiftly it takes action to prevent or mitigate their recurrence and to provide for or support their remediation.

WORK towards institutionalizing a process step that requires the FI to ask itself about the form of involvement with harm to shape decisions on action, where this capacity has been built.

MYTH FOUR

REMEDY IS IRRELEVANT WHERE THE FI HASN'T CAUSED OR CONTRIBUTED TO IMPACTS

An FI is not expected under the UNGPs to directly **provide** remedy itself where it is linked to impacts in its portfolio through its financing - though it can always choose to take a role in remedy. However, where impacts linked to FIs products or services it should use its **leverage** to seek to prevent or mitigate the impact – and as part of this, it should consider whether and how leverage can be used to **enable remedy**, by influencing the client or other responsible party to provide it.



Reflecting this more nuanced understanding of the responsibility to respect, leading FIs are coming to recognize that they have a role in enabling remedy in linkage situations, even where a client or third party may have primary responsibility to provide that remedy. The graphic above highlights how this fits into the UNGPs' expectations on differentiated responsibility.

EMERGING GOOD PRACTICES

FIs have begun exploring the roles they can play to support the provision of remedy by clients or other responsible parties (without shifting that responsibility to directly provide remedy to the FI itself). This involves acknowledging that the FI operates within a remedy ecosystem and can take important steps to strengthen it. For example, emerging practices involving leverage for remedy include supporting mediation, engaging with peer FIs in a transaction to bring greater focus to the need for remedy and engaging a group company with whom the FI has greater leverage.

TAKING A STEP IN THIS DIRECTION

LOOK OUT for a situation requiring remedy for impacted parties which is linked to your financing.

IDENTIFY the affected stakeholders and the parts of the remedy ecosystem that are relevant to the provision of remedy in this case.

ASK if we wanted to help these parties get to remedy, what are the roles we could play to make remedy more likely and more effective?

In addition to some of the emerging practices listed above, **CONSIDER** whether you can focus client engagement on remedy, support credible fact-finding, or find a way to facilitate consultation with affected stakeholders.

MYTH FIVE

TALKING ABOUT REMEDY MEANS THE FI IS BEING ASKED TO OPEN UP ITS CHECKBOOK AND ACCEPT FULL RESPONSIBILITY ITSELF

The persistence of this myth has a chilling effect on important internal conversations within FIs about remedy. As noted above, in many (but certainly not all) cases, the FI will be linked to the impact (as opposed to causing it or contributing to it) and another party will have the responsibility to provide remedy – including financial compensation where appropriate. But as we have noted above, there are many important roles that FIs can play that don't involve directly paying financial compensation. Similarly, taking steps to ensure that other parties meet their responsibilities with regard to remedy does not mean the bank is accepting responsibility for remedy itself. Rather, it means the bank recognizes that an impact has occurred and stakeholders need to be made whole again. The primary role in doing this will need to be undertaken by the parties that caused or contributed to the impact.



LEADING PRACTICE

As noted above in respect of Myth 4 a number of FIs have started working on strategies to enable remedy. Sustainability teams within FIs have been actively discussing banks' responsibilities and commitments with respect to the UNGPs with their legal teams, and engaging external capacity building support where helpful.

TAKING A STEP IN THIS DIRECTION

START CONVERSATIONS sooner rather than later – internal alignment here is key. The leading practice examples we set out herein may provide some comfort to colleagues who are fearful about the remedy by illustrating the range of possible roles FIs can play to enable remedy. It can be useful to clearly separate the “what” – the need for impacted stakeholders to be made whole – from the discussion about “who” will provide remedy and “how.”

Financial Institutions and Remedy: Myths and Misconceptions

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This resource was authored by Ashleigh Owens and David Kovick.

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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

Shift's Financial Institutions Practitioners Circle is a carefully designed space for practitioners working within financial institutions to discuss human rights challenges and co-create cutting-edge solutions that fit their unique reality.

In addition to peer conversations, Shift's FIs Circle membership provides access to 101 training on core concepts of the UNGPs – including remedy – to which members may invite key internal stakeholders from across the institution. To learn more visit: shiftproject.org/fiscircle/ or contact us at: info@shiftproject.org.