accountability counsel

Accountability Mechanisms:
Benefits and Best Practices for Impact Investors

The field of impact investing has grown exponentially in recent years, as more and more asset managers and their clients decide to use their investments to contribute to positive environmental and social impact. Many impact investors seek to learn from and improve upon the practices of development finance institutions (DFIs) that have similarly sought to use capital to produce positive development outcomes.[1] One common feature of DFIs that is increasingly crucial for the impact investing space is the "accountability mechanism." Accountability mechanisms—also known as community feedback mechanisms—are independent units housed within DFIs that receive and address grievances brought by local communities that have been adversely affected by DFI activities. From their decades of experience, DFIs have realized that success depends on avoiding negative environmental and social impacts and accounting for harm to communities caused by development projects. These mechanisms serve as valuable tools to avoid and address this harm. Impact investors must heed this lesson. Accountability mechanisms can play an important role in ensuring a responsible approach to investing for impact by providing a way for investors to reduce the risk of harm and mitigate adverse effects that can threaten the sustainability of their investments and undermine their impact objectives.

Why are accountability mechanisms necessary?

Impact investors, like DFIs, seek to *create* positive impact. Investors engaged in other forms of socially responsible investing may seek out investments in enterprises based on good environmental, social, and governance indicators. However, those investors are not necessarily providing otherwise unavailable capital or some other sort of value to help enterprises generate positive impact. By contrast, impact investors generally engage in financing activities to contribute to enterprises' social aims, catalyzing impact that would likely not happen in the absence of their investments.[2]

However, the experience of DFIs demonstrates how these types of catalyzing financing activities can also contribute to unintended *negative* impacts. Large infusions of capital and other attendant changes in circumstance can create unintended harm to local communities, especially the most vulnerable groups within them. Harm to vulnerable communities in fragile environments can occur whether an investment is in renewable energy projects, the health and education sectors, or Opportunity Zones. This harm can undermine the very impact that impact investors are seeking to achieve.

Accountability mechanisms, however, put communities at the center of the investment. They provide a key feedback tool for investors to engage directly with affected communities and mitigate, redress, and prevent harm, allowing the investment to realize more sustainable benefits and outcomes. Furthermore, they provide a critical space for communities to voice concerns about

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[1] The International Finance Corporation, one such DFI, even refers to itself as "one of the original impact investors." International Finance Corporation, *Creating Impact: The Promise of Impact Investing*, p. 33, Apr. 2019, *available at* https://www.ifc.org/creatingimpact.

[2] *Id.*, p. 1.

the investment and jointly work through solutions, enabling them to play a fundamental role throughout the investment cycle.

Where impact investors have environmental and social protections in place, accountability mechanisms can also ensure compliance with relevant policies and procedures. They offer invaluable insight on where non-compliance exists and how the investor can close policy gaps that would otherwise impair the ability of current and future investments to deliver positive impacts.

How do accountability mechanisms work?

Accountability mechanisms serve as a means to formally collect, evaluate, and resolve community complaints related to an investment. An accountability mechanism administers an independent process for addressing complaints and resolving disputes about the investment's negative environmental and social impacts. Accountability mechanisms utilize a set of well-known, established procedures to resolve grievances, review compliance with internal environmental and social policies and procedures, and provide remedy when investments and their associated projects cause harm.

Although the structure and approach of existing accountability mechanisms vary, they often take the form of a formal complaint unit within a DFI or government agency and outside the judicial system. The unit has specialized personnel who independently administer the functions of the mechanism and provide a culturally appropriate, neutral forum for communities to raise grievances and seek remedy. These functions generally take the form of two basic feedback tools: professional dispute resolution and independent compliance reviews (when auditable policies are in place).

Most major DFIs rely on accountability mechanisms as a tool to identify and respond to adverse project impacts, foster respect for the institution's policies, and ensure the successful completion of projects without unnecessary costs and delays.[3] That a variety of institutions, ranging widely in size, scope, purpose, and investment instruments, have been able to establish accountability mechanisms and capture their benefits demonstrates that procedures can be tailored to new contexts, such as impact investing.

What are the benefits of accountability mechanisms?

Accountability mechanisms can bring value and lasting benefits to impact investors in a variety of ways. For example, accountability mechanisms provide an opportunity to efficiently address

[3] For example, the following DFIs, export finance and development agencies, and international organizations have accountability mechanisms: the African Development Bank, Asian Development Bank, Asian Infrastructure Investment Bank, Australian Export Finance and Insurance Corporation, Black Sea Trade and Development Bank, Brazilian Development Bank, Canadian Office of the Extractive Sector, Caribbean Development Bank, European Bank for Reconstruction and Development, European Investment Bank, Export Development Canada, French Development Agency, German Investment Corporation, Green Climate Fund, Inter-American Development Bank, International Finance Corporation, Japan Bank for International Cooperation, Japan International Cooperation Agency, Netherlands Development Finance Company, Nippon Export and Investment Insurance, Nordic Investment Bank, UN Development Programme, U.S. Overseas Private Investment Corporation, and World Bank. Additionally, governments adhering to the Organisation for Economic Cooperation and Development's Declaration on International Investment and Multinational Enterprises are required to establish "National Contact Points" to receive complaints.

complaints and settle disputes at an early stage in an investment's life cycle. Through accountability mechanisms, impact investors can resolve relatively small disputes before they escalate into widespread grievances that require expensive, time-consuming remediation measures.

In addition, accountability mechanisms are sources of knowledge and learning that translate into more sustainable investments and better impact outcomes. Through the complaint process, impact investors can detect problems in an investment's design, implementation, or viability, correct them at the outset, and prevent them from occurring in future investments. They also help impact investors diagnose weaknesses in operations, management, or systems and determine how to improve them.

Accountability mechanisms enhance the ability of impact investors to address concerns about an investment in a just and fair manner. Accountability mechanisms also give communities a neutral and independent forum through which they can express their concerns without fear of retaliation or reprisal and seek remedy for harm that the investment has caused. Through a complaint process that reduces power imbalances between relevant parties, impact investors can demonstrate their interest in the wellbeing of the community and build trust and respect with its members. When impact investors and other parties associated with the investment or project engage with communities to develop solutions, they foster dialogue and more cooperative relationships that ultimately increase project success and reduce the risk of community discontent and broader instability.

Furthermore, accountability mechanisms provide a more accessible, flexible, and collaborative approach to dispute resolution than formal court proceedings. They are less costly for all parties and have the potential to deliver more timely resolutions to community grievances that may otherwise lead to litigation or further harm. Accountability mechanisms offer a reliable, alternative venue that can achieve impartial and transparent outcomes.

In addition, by resolving complaints through accountability mechanisms, impact investors can avoid high-profile allegations of abuses that lead to severe reputational damage. Because of their role in promoting responsible development practices and providing remedy for adverse impacts, accountability mechanisms enhance the reputation and legitimacy of impact investors that use them. They demonstrate that the impact investor is committed to sustainable outcomes for shareholders as well as for the communities that are affected by their development projects.

What are the best practices for accountability mechanisms?

To maximize the benefits that an accountability mechanism can provide, the investor should ensure that the mechanism is based on best practices.[4] An accountability mechanism that is poorly designed or implemented not only diminishes its value to the impact investor, but it also risks compounding grievances among affected people and overlooking project deficiencies. Accountability mechanisms need to be structured according to a set of underlying principles, such

[4] The International Finance Corporation's Compliance Advisor/Ombudsman is often cited as an accountability mechanism that has adopted a number of best practices.

as the effectiveness criteria identified by the UN Guiding Principles on Business and Human Rights, discussed below.[5] Best practices must then flow from these principles:

- **Legitimacy:** An accountability mechanism should have an independent governance structure to ensure that the process is fair and has the trust of the affected people. The mechanism should be able to function independent of pressure from those responsible for the day-to-day financing operations, whose actions may be the source of grievances. The mechanism should also have sufficient authority to handle grievances and make redress decisions objectively.

  Best practice examples[6]
  - The committee formed to select the mechanism principals should include outside stakeholders, including representatives of civil society.
  - Mechanism principals should be required to respect a cooling-off period before joining the mechanism if they have previously worked for the impact investor. The principals should be restricted from working for the impact investor following their tenure at the mechanism. Mechanism personnel should also be required to recuse themselves from complaint processes that related to matters in which they have a personal interest or had significant involvement with in any capacity.
  - The mechanism should establish an official external stakeholder advisory group, which includes representatives of civil society, to provide it with feedback and guidance on their work.

- **Accessibility:** In order to serve as a reliable forum for providing access to remedy, a mechanism should be well known to all potentially affected people and provide adequate assistance to help them overcome barriers to accessing it, including "language, literacy, costs, physical location and fears of reprisal."[7] The impact investor should ensure that affected people have access to the mechanism, including a requirement that investees and project operators inform people of the existence of the mechanism and its functions. In addition, the mechanism should not impede access to remedy through other means, whether non-judicial or judicial, or require people to use the mechanism before pursuing other avenues for remedy.

  Best practice examples
  - The impact investor should require investees and project operators to disclose the availability of the mechanism to potentially affected people at the earliest stages of the investment. Subsequently, any project-level grievance mechanism should be required to provide information about the impact investor's mechanism to any interested stakeholder, including community members.
  - The mechanism should accept complaints requesting either professional dispute resolution or independent compliance review from when the investor has indicated

[5] UN Guiding Principles on Business and Human Rights, Implementing the United Nations "Protect, Respect and Remedy" Framework, Principle 31, *available at* https://www.ohchr.org/documents/publications/GuidingprinciplesBusinesshr_eN.pdf.
[6] For a more complete list of best practice examples, *see* C. Daniel, K. Genovese, M. van Huijstee & S. Singh (Eds.), *Glass Half Full? The State of Accountability in Development Finance*, Jan. 2016, *available at* glass-half-full.org.
[7] UN Guiding Principles on Business and Human Rights, at Principle 31(b) and Commentary.

it is considering financing. Complaints requesting dispute resolution should be accepted as long as the loan is in repayment or the impact investor maintains its investment. Complaints requesting compliance review should be accepted even after the project is closed.
    - The impact investor should provide a highly visible link on its homepage to the mechanism's website.
    - The mechanism should allow complaints in the language of the complainant and should provide information on its website in multiple languages.

- **Predictability:** The accountability mechanism should have clear and known procedures with timeframes for each stage of the process. The timeframes should be explicit and clearly communicated to potentially affected people, and the mechanism should have a way to monitor that the process and parties are respecting those timelines.

    Best practice examples
    - The mechanism must consistently meet its deadlines in processing complaints.
    - The impact investor must provide the mechanism with a sufficient budget to allow it the capacity to handle its caseload.
    - The mechanism should provide regular status updates to complainants.
    - The impact investor should develop responsive "action plans" that address every finding of non-compliance identified by the mechanism with a time-bound, implementation plan.
    - The mechanism should be given the mandate to monitor commitments made through dispute resolution and instances of non-compliance found through compliance review. One important distinction to be made here is that the mechanism should monitor whether the instances of non-compliance have been remedied, not whether the action plan has been implemented, as the action plan may not always adequately address the instances of non-compliance. The mechanism should publish monitoring reports at least once a year, which incorporate information provided by complainants on the implementation of the commitments made by the impact investor, its investees, or project operators.

- **Equitability:** To ensure that people can engage in a process on fair and equitable terms, they must receive non-biased information and advice. Affected people are often not well informed of their rights or options for recourse, and may be severely disadvantaged in their access to resources and information compared to impact investors, investees, and project operators. In order to facilitate an equitable and fair process and maintain trust, the mechanism should provide information on the process and inform people of their right to consult with and be accompanied by counsel and/or advisors at any time during the process.

    Best practice examples
    - Complainants should be given the same opportunity as the impact investor to review and comment on the mechanism's reports. The final report should be sent to the complainants at the same time it is sent to the impact investor's board of directors (or, in the absence of a board, some other high-level entity), and it should contain the perspectives of the complainants.

- The impact investor should develop and implement procedures for robust and participatory consultation with complainants prior to the development of an action plan.
- The mechanism should respect the role of complainants' advisor(s) and representative(s).
- The impact investor should create an appeals process for those complainants who are unsatisfied with the results of the complaint process or the implementation of commitments by the impact investor, its investees, or project operators.
- The impact investor should provide sufficient resources to the mechanism to allow it to carry out its mandate and ensure complainants can meaningfully participate in the process.

- **Transparency:** Transparency can be key to building and maintaining confidence in the mechanism within affected communities, as well as with shareholders and the general public. This includes keeping parties to a complaint process informed about its progress and reporting to the public regarding the mechanism's activities. The mechanism should maintain a publicly available case registry, including an online version, in addition to any other culturally appropriate means of disseminating this information. The mechanism should not require parties to agree to a blanket confidentiality agreement as a prerequisite to participate in the complaint process. However, it should protect the identity of any party that requests confidentiality.

  Best practice examples
  - The mechanism should ensure its case registry contains all relevant information.
  - The impact investor should publish comprehensive information on the activities it finances, including environmental and social assessments, in a format and language that is accessible for those who will be affected by them. The investor should publish information regarding the sub-projects supported by its financial intermediary investees.

- **Rights compatibility:** In order to be considered effective and legitimate, accountability mechanisms must provide outcomes and remedies that align with internationally recognized rights. Outcomes and remedies should respect applicable rights under national and international law. Any monitoring and evaluation efforts of the mechanism should also include a review of these outcomes and remedies for their rights compatibility.

  Best practice examples
  - The impact investor should make an explicit commitment not to make an investment that would cause, contribute to, or exacerbate human rights abuses. To operationalize that commitment, the investor should require investees and project operators to undertake assessments of human rights impacts. Assessments should include whether there are sufficient protections for civil society to voice objections about the activity being financed. The investor should refrain from financing activities in contexts where it is not possible to comply with relevant policies, including provisions related to consultation and information disclosure.
  - The impact investor and mechanism should adopt protocols for protecting complainants from reprisals and responding to them should they occur.

- The mechanism should be given the mandate to make recommendations to suspend financing or processing of the financed activities when it believes imminent harm could occur.
- The impact investor should require investees and project operators to contribute to the investor's (or third-party's) administered contingency arrangement, such as a fund, insurance plan, or bond, to provide financial or other remedy in case adverse impacts occur. Contributions should be based on investment risks and built into the impact investor's contractual arrangement with relevant parties associated with the investment. When policy violations and/or adverse impacts are found, the impact investor should employ compliance remedies, such as the activation of a contingency arrangement (e.g., fund, insurance plan, bond, etc.) and appropriate sanctions, including the option of funding termination or responsible exit.

- **A source of continuous learning:** In addition to resolving individual grievances, effective accountability mechanisms can serve a valuable role by providing feedback for the investment cycle and the impact investor's, investee's, and project operator's operations. The impact investor should incorporate a process for identifying lessons learned from the accountability mechanism, implementing improvements, and monitoring progress to avoid future harm and unsustainable investments. There should also be a monitoring and evaluation process of the mechanism itself to verify that it is fully carrying out best practices.

  Best practice examples
  - The impact investor should develop a publicly available management tracking system that documents how it has responded to the mechanism's findings and recommendations, what lessons it has learned from the mechanism's cases, and how it will apply those lessons to future investments.
  - The impact investor should refrain from providing additional financing for similar activities when the mechanism has identified non-compliance with relevant policies until those instances of non-compliance have been rectified. Prior to financing other activities that pose similar risks, the impact investor should ensure that it has applied the lessons of previous cases.
  - The mechanism should document lessons learned from its cases in order to facilitate improved investment policy and practice.
  - The mechanism should have the primary responsibility of developing and reforming its own rules of procedure. Only reforms that would result in significant changes to the mechanism's structure or mandate should require approval by the impact investor's board of directors.

- **Based on engagement and dialogue:** The impact investor should hold consultations about the design, performance, and monitoring and evaluation of the accountability mechanism. This will ensure that it maximizes value to the investor in the form of useful feedback and that it meets the needs of communities. The participation of potentially affected communities and the public is critical to the development of a culturally appropriate mechanism that can respond effectively to their concerns and address harm caused by an investment.

Best practice examples

- Consultation processes for reviews of the mechanism's rules of procedure or the policies establishing them should be standardized. The process should include both the opportunity for comment from relevant stakeholders, such as the investor, communities, and civil society, and the disclosure of the final version under consideration for approval.
- Regular reviews by mechanism users and other stakeholders of the mechanism's performance and the impact investor's responsiveness to the mechanism's findings should be conducted (which could take the form of open and solicited feedback opportunities, workshops, consultations, etc.). Independent, third-party audits may be used to facilitate or complement this feedback loop. The impact investor and mechanism should publicly report on actions to address this feedback.
- The mechanism should establish an official external stakeholder advisory group, which includes representatives of civil society, to provide it with feedback and guidance on its work (see also under **Legitimacy**).

Accountability mechanisms that incorporate best practices can serve as an effective tool for impact investors to maximize positive impact, redress negative impact, and improve the sustainability of their investments. Through accountability mechanisms, impact investors can also ensure that they respect their internal environmental and social policies, prevent abuses and poor impact outcomes, and appropriately respond to harm. They not only provide a way to bring value to the people affected by investments, but they also contribute to the long-term success and legitimacy of the impact investors that adopt them.