The EU Corporate Sustainability Due Diligence Directive: Key Questions Answered

The EU's proposal for a Corporate Sustainability Due Diligence Directive (CSDDD) has been the subject of significant debate, particularly during the last few months of trilogue negotiations. As we move towards the final trilogue discussion of the year, a number of key issues remain unresolved, including whether to include the financial sector in scope and requirements to adopt transition plans compatible with the Paris Agreement.

These issues have become key points of discussion in the negotiations. Some have argued that the CSDDD will reduce European companies' competitiveness, impose unworkable burdens on the financial sector, and duplicate existing EU obligations. But this does not have to be the case. Appropriately designed, the CSDDD can help to plug the gaps in the EU's regulatory framework by complementing transparency laws with requirements to take action to support the transition of the real economy. It can also address the piecemeal approach to due diligence within existing legislation and create a level playing field in the EU, setting a high standard globally.

This paper seeks to provide clarity on some of these key discussion topics, and highlight potential ways forward that can help to ensure the CSDDD is ambitious and workable in practice.

What is the CSDDD?

The Corporate Sustainability Due Diligence Directive (CSDDD) is a proposed EU law which would require companies to identify, mitigate, prevent, bring to an end, and report on the impact of their operations and those of their business relationships on human rights and the environment. The Directive aims to harmonise corporate sustainability due diligence requirements across the EU, which until now have been addressed through a patchwork of legislation.

What obligations would it impose on whom?

The scope of the Directive is still being negotiated. Under the Commission's proposal, it would apply to **large companies** (>500 employees and >€150 million turnover generated inside the EU), and **medium-sized companies** exposed to particular risks (>250 employees, >€40 million turnover, >50% of revenue from high-risk industries) operating in the EU.

These companies would be required to identify, prevent, mitigate and bring to an end adverse human rights and environmental impacts caused by activities in their operations and those of their business partners. They would also have to adopt plans to align their business model and strategy with the goal of limiting global warming to 1.5°C (Art.15) and, where they are not in scope of the EU Accounting Directive, publish an annual report on their sustainability due diligence activities (Art. 11).

Could the CSDDD be detrimental to financial institutions' competitiveness?

No. Undertaking due diligence on the sustainability profile of holdings is already a well-established component of many financial institutions' risk management toolkits.

EU financial institutions adhering to the CSDDD may also benefit from certain competitive advantages. By establishing robust, risk-based practices for sustainability due diligence fit for their global value chains, financial institutions will be better placed to identify, manage and mitigate adverse sustainability impacts they are exposed to. This will also introduce a clearer framework for their stewardship and engagement efforts, reducing climate-and environment-related litigation risks. This was echoed recently by Frank Elderson, Member of the Executive Board of the European Central Bank (ECB) and Vice-Chair of the ECB's Supervisory Board. Finally, this will provide reputational benefits in bolstering the credibility of the EU financial sector's sustainability pledges.

Could it be workable in practice for financial institutions?

Yes, if it recognises and accounts for the nuances of how sustainability due diligence is carried out in practice. In recognition of the important but distinct role that financial institutions have to play in carrying out due diligence, the OECD has published a range of specific guidance, including for institutional investors, corporate lending and securities underwriting, and project and asset finance. Many investors are familiar with or actively applying the guidelines and some have already called for the CSDDD to bring financial institutions into scope on this basis.

In particular, **the CSDDD requirements should follow the risk-based approach to due diligence, in line with the OECD guidelines**. This states that due diligence efforts should be proportionate to the likelihood and severity of adverse impacts, and where adverse impacts identified and assessed cannot be addressed all at once, then companies can prioritise those impacts that are deemed most severe. This approach allows investors with large numbers of investee companies in their portfolios to engage with the highest-impact companies they hold, enabling targeted and effective risk management.

For CSDDD to be workable, it must also recognise that the way in which institutional investors and other financial market participants undertake due diligence and engage with their value chains is not the same as for companies operating in the real economy. Investors do not have contractual relationships with their investees; instead, they seek to influence their investee's behaviour through active ownership and engagement. Also in most instances, investors will be linked to adverse sustainability impacts through their ownership stake in and/or financing of investees, rather than directly causing or contributing to these impacts themselves. Where investors are only linked to adverse impacts, they should not be held liable for these impacts.

The Parliament's text introduces provisions that seek to acknowledge these nuances in the form of Article 8(a), with an emphasis on stewardship and engagement as the key levers that investors have at their disposal to influence their holdings. Moreover, the requirements state that action should be proportional to the degree of influence the investor has, with due

regard to the degree of control they have over their investees. While further work should be done to refine the provisions, they nonetheless provide a clearer and more practicable basis for including institutional investors within the scope of the CSDDD.

Will CSDDD transition plan requirements oblige investors to achieve their commitments?

No. The requirements to adopt and implement transition plans are understood as an obligation of means, rather than an obligation of results. In-scope companies would be required to implement these plans and set targets on a best-efforts basis, proportionate to their resources and exposures to and/or impacts on climate change. The CSDDD should not require investors to reach certain targets in the plans, nor hold them legally liable in the event the targets are not achieved. In other words, investors do not face an 'obligation of results'.

Can the transition plan requirement in the CSDDD's Article 15 complement existing transition plan-related requirements?

Yes, it can. Transition plan disclosure requirements already exist under the Corporate Sustainability Reporting Directive (CSRD). The content of Article 15 can be aligned with these disclosure rules and the European Sustainability Reporting Standards, including short, medium, and long-term emission reduction targets. This will make them actionable and mitigate the risk of greenwashing.

Can the CSDDD complement existing due diligence obligations for the financial sector?

Yes, it can. Due diligence (or elements thereof) is already referenced in the current EU sustainable finance framework, including notably under the Sustainable Finance Disclosure Regulation (SFDR), CSRD, UCITS, and AIFMD delegated acts. Most of these requirements are disclosure-based, while the delegated acts introduce high-level requirements to act on sustainability risks and on any Principal Adverse Impacts, where considered under SFDR.

The CSDDD gives co-legislators the chance to create a coherent and harmonised understanding of good investor due diligence practice across the EU sustainable finance framework and to provide precise sectoral guidance for investors on this. Investors should be able to use and augment the instruments they already have at their disposal to meet CSDDD requirements (including those put in place to comply with SFDR). As noted in the Commission's original proposal, the CSDDD provides an opportunity to underpin and complement disclosure made under SFDR with requirements to implement the necessary processes and frameworks for carrying out due diligence in practice.

The same applies for investors and financial institutions in scope of the CSRD. CSRD will require a wide range of companies and financial institutions to report on human rights and environmental due diligence, the adverse impacts of their activities on sustainability factors, and transition plans that are compatible with a 1.5°C world. Disclosure and reporting are the final stages of the due diligence process: CSDDD provides a basis for companies to

establish robust processes to gather information, identify and assess due diligence requirements, and implement transition plans in practice.

Disclaimer: This document was developed by IIGCC, Eurosif, and PRI but does not necessarily represent the views of our entire membership / signatory base, either individually or collectively.

Annex

The following is a selection of statements from key stakeholders supporting the inclusion of financial institutions in the CSDDD:

- Speech by **Frank Elderson**, Member of ECB Executive Board, Vice-Chair of the Supervisory Board, highlighting CSDDD's benefits for financial institutions
- Letter from **Dutch financial system** (Dutch pension funds alone hold assets over €1.4 trillion)
- Statement including financial institutions such as **Aviva Investors** (£223 billion assets under management), Crédit Mutuel Asset Management and La Banque Postale Asset Management
- Statement including **Robeco** (€200 billion assets under management), Storebrand Asset Management, Sustainalytics, Triodos Bank
- Statements by Richard Kooloos, Global Head of Social Impact and Human Rights at **ABN AMRO Bank** (assets of €380 billion)
- Statement by 4 Nordic investors calling for financial sector inclusion in the CSDDD

Further reading

- **IIGCC Position Paper for CSDDD Trilogues**
- **PRI Position Paper on how to make the CSDD directive practicable for the investment industry**
- **PRI statement on appropriate and practicable inclusion of the financial sector in the CSDDD**
- **Eurosif: Joint statement of support by responsible investors organisations for the CSDDD**