EBF position paper on the Corporate Sustainability Due Diligence Directive (CSDD)

Key points and recommendations:

- We support the objectives of the proposal to advance respect for human rights and environmental protection and embed these aspects into supply and value chains, to create a level playing field and to avoid fragmentation amongst Member States (MS). The financial industry has already progressed significantly on alignment with established international soft law standards, namely the UN Guiding Principles on Business and Human Rights (UNGPs) and the OECD Guidelines. These standards set out a responsibility for banks to conduct ongoing due diligence to identify impacts with which the bank might be involved, through its own activities, or which may be directly linked to its operations, products or services by its business relationships. The current proposal differs substantially from these two standards, which would have significant adverse impact on banks that have already committed and established processes based on these international standards.
- We welcome EU regulation regarding due diligence on environmental and social impacts, but we see a rather large room for MS in the transposition of directive. Thus, it entails a risk of gold plating which leads to a need for close monitoring. Furthermore, we would ask to avoid an excessive fragmentation, if possible, exactly to preserve the level playing field also inside the EU. Further, we find that the proposal lacks on several aspects and would recommend the following:
  - **Clarity on obligations and definitions**
    - There is a need to elaborate on the extent of some of the essential obligations of the proposal, e.g. due diligence. We find it necessary to distinguish between operational supply chains and clients as part of the value chain of financial institutions. In order to be able to fulfil these obligations, financial institutions need to be provided with clarity and legal certainty with regard to the expectations on the due diligence, definition of clients and of other companies belonging to the same group and established business relationship respectively and the scope of the financial products/solutions covered. These expectations should take into account the differences in terms of business model between financial institutions and companies of the "real economy" and provide for requirements that are appropriate in this context.
    - The directive should clarify whether it is asking financial entities to identify the adverse impact just once during the onboarding of the client or for each new product/service contract a company is selling to a same client.
    - We want the obligations to apply at the consolidated group level. Consequently, subsidiaries should be expressly exempted.
  - **Legal framework**
    - Mandatory due diligence introduced in the Directive should be based on and aligned with the UNGPs, not introduce a new, UNGP-resembling definition of due diligence. Further, it is crucial to ensure consistency and alignment with relevant legislation in this area, e.g., Taxonomy Regulation, SFDR and CSRD.
    - The transition plan requirement in this directive could complement the same requirement in the CSRD, the latter being limited to reporting on the plan. However, the CSRD mandates the European Commission to specify,

by delegated acts, the information to be included in the transition plan, while in this directive remains general. To ensure complementarity between the two texts, this directive should refer to the CSRD, which should be possible as the CSRD will be adopted before this directive. It should be highlighted that as a matter of principle we wish to avoid the multiplication of delegated acts.

  - The proposed delegated powers of the European Commission need to be clear to ensure that the European Commission cannot lay down additional obligations for companies nor directors.

- **Directors' Duties**
  - The Directive intends that directors should take into account human rights, climate change and environmental consequences when taking decisions in the best interests of the company. Given that consequences of any kind of "sustainability matters" are very broad, with regard to the responsibility for directors, it is important to provide legal certainty particularly in light of the liabilities of directors.
  - Moreover, the notion of "directors" should be clarified. At this stage the proposal does not seem to distinguish between executive and non-executive directors, or even between members of the board of directors or senior managers. We would favour a clarification. The proposal seems somehow vague on the notion of stakeholders.
  - As the national Corporate Governance rules will apply and Member States are responsible it is important that the obligations established by the EU Directive are complementary and there is flexibility given that they do not affect the relevant national corporate governance frameworks. Thus, it should be clarified that a duty to consider sustainability matters can only apply within the scope of responsibilities allocated to directors by the applicable national corporate governance rules and apply within the framework and without affecting directors' general obligation to act in the interest of the company and its shareholders in accordance with the applicable national corporate governance laws.
- **Civil liability**
  - We strongly oppose the inclusion of the proposed provisions on civil liability (article 22) and the payment of damages to affected groups (article 8) in the Directive. They go against the established principles of national civil law and create an unaccountable and uncertain legal risk for companies, which might go against the objectives of the Directive.
  - Should civil liability be retained in the Directive, the legal text requires a major overhaul and should be made clear, predictable and appropriate.

General comments on the proposal:

I. Subject matter (Article 1)

As the directive is not fully harmonised, there is a risk of disparate national rules. We seek for full harmonization.

The extent of the due diligence obligation is very wide, not limited to actual and potential human rights **severe** adverse impacts and to actual and potential environmental **severe** adverse impacts (except for companies referred to in article 2(1), point (b) and article 2(2)-point b). Therefore, we would make use of the risk-based approach and the established definitions, such as severity/salience etc. UNGPs: *Severity of impacts will be judged by their scale, scope and irremediable character*.

II. Scope (Article 2)

The obligations should apply at the consolidated group level as that is where due diligence policies and processes are set up. It would be a disproportionately high administrative burden for each entity of a banking group to comply with the obligations laid down by the Directive. Therefore, subsidiaries should be expressly exempted.

Moreover, considering that the obligations (and liability for breach of the same) regarding adverse impacts extend not only to own operations, but to the operations of subsidiaries and of the established business relationships within the value chain (also of the value chain of affiliates?), we find it unclear, if this means that, de facto, all subsidiaries (and their value chains as the case may be) would be under the scope of the Directive even though they might not be subject to it according to relevant thresholds.

We find that the proposal should clarify how companies that are subject to the law but registered in third countries, would be sanctioned. In addition, to this, information on the relevant authority should be mentioned.

III. The definition of "company" for regulated financial undertakings (Article 3)

The definition of a client in the financial sector value chain should be included in the proposal. The proposal does not provide a definition of a client, and therefore it is not clear if other forms of legal persons than companies, as defined in article 3(a), are in the scope of mandatory due diligence.

IV. The definition of value chain for credit institutions (Article 3)

The definition of an established business relationship and value chain need to be clarified and coordinated (article 1 and article 3). All business agreements of the banks are covered by the directive both where a customer uses the bank`s services (not only financing) and when the bank on itself buys services. The definition should be clarified.

The notion of 'established business relationships' (article 3 f) that underpins the depth of the due diligence obligation should be clarified:

- do banks need to have an "established business relationship" with their clients? It should be clarified what the criteria are with regards to e.g. the duration or value of the contract and would e.g. renewing a line of credit trigger a new due diligence process.

The definition of a value chain for the financial sector should also be clarified:

- The inclusion of the client's subsidiaries within the value chain should be limited to the subsidiaries signing the relevant contract. For example, in the case of a non-dedicated loan banks do not know for which activities the financing will be used and which specific subsidiaries activities would be involved. Therefore, providing that service would mean an unpredictable legal risk for the bank.
- Regarding „other financial services", the proposal could be read as requiring that the due diligence duties refer to all services financial institutions provide. Financial services covered should be limited to the provision of credit and lending.
- The exclusion of SMEs from the value chain of credit institutions is foreseen for financing and insurance services, however it is unclear whether they would be subject if they are provided other financial services. We are of the view that SMEs should be excluded when providing any regulated financial services, be it loan or credit or for example a payment service or an investment service.

V. Integrating due diligence into companies' policies (Article 5)

The Directive appears to be vague in its definition of what a due diligence policy consists of. In particular, it is not clear what is meant in Article 5.1(a) with the "*company's approach*" to due diligence. A clearer definition of what constitutes a due diligence policy and its key features would be welcomed, also to avoid uncertainty for directors/ "Management body in its executive function" and "Management body in its supervisory function" when exercising their responsibility for "putting in place and overseeing" such policy in accordance with Art. 26.

We believe that the norm should clarify what the expectations are with respect to FIs due diligence obligations and underline what would be additional requirements which would not be already covered by existing regulations (AML, MIFID, Credit admissions, etc). We suggest that the EBA could define a standardise template/checklist of documents/data to be collected that FIs should use in the onboarding process. By being standardised it will give clarity to companies on what FIs expect of them and it will simplify all the verification process leveraging on "common and standardized" approach. However, the template, while being standardised, must provide entities with flexibility to adapt it to the clients in relation to their size, sector, financial product, local specificities, and overall risk-based approach (customer risk profile, risk appetite etc) – the same level of scrutiny should not be expected for a payment product than for global credit for example.

In large institutions where many policies exist covering all aspects of the business and operations, there will be some policies that will not need any due diligence provision to be added to them. The discretion to determine which policies need to be amended should be left to the company implementing compliance with the ruleset. In addition, article 5 establishes that "*Member States shall ensure that companies integrate due diligence into all the corporate policies and have in place a due diligence policy*". We consider that the obligation to set a specific due diligence policy should be left to the discretion of the company´s internal management and organisation, which should evaluate whether its existing policies already cover the requirements of the Directive.

VI. Identifying actual and potential adverse impacts (Article 6)

Moreover, it is foreseen that when credits institutions provide credit, loan or other financial services, identification of actual adverse human rights impacts and adverse environmental impacts shall be carried out only before providing that service. However, under article 10, companies must carry out periodic assessments, at least every 12 months, to monitor the effectiveness of the identification, prevention, mitigation, bringing to an end and minimisation of the extent of human rights and environmental adverse impacts. A clarification of the interaction of these two articles would be welcomed. Moreover, the periodic assessment every 12 months is not operationally feasible on the entire value chain. We can suggest: "appropriate periodic assessments"

The reference again to 'other financial services' appears, and this should be aligned to the changes asked to be made to the definition of value chain in Article 3.

We highlight the potential contribution that ESG Ratings may have in the due diligence process, in order to add elements of standardisation. While nowadays the ESG ratings market has some limits and it lacks transparency, the European Commission is considering a legislative initiative on ESG Ratings soon. Currently the ESG ratings are used by financial institutions also for clients' ESG assessments purposes. It should be investigated how ESG ratings could play a role in the due diligence process provided by the Directive and if they can support financial entities in the task. The use of recognised and supervised common metrics could help avoid very inconsistent results in the due diligence made by different financial institutions on the same client.

Finally, we understand that Art. 6(3) of the draft requires FIs providing credit loan or other financial services to be obliged to identify actual or potential adverse HR or environmental impacts only before providing the service. Thus, we would like to have clarified whether article 8 applies to FIs.

VII. Preventing potential and bringing the impact to the end (Articles 7 & 8)

The fundamental principles of honouring existing contracts, *pacta sunt servanda*, need to be respected and safeguarded. Therefore, the proposed obligation to terminate a contract when potential adverse impacts could not be prevented or mitigated or when actual adverse impacts could not be ended should be removed. Their inclusion might also violate the prohibition against retrospective legislation. It would disproportionately disrupt the existing business of companies, undermining the overall market stability.

It remains unclear whether the appropriate measures, except for the specific exclusion of requirement to terminate a service contract, apply to the provision of financial services. This would seem unreasonable, as the financial undertakings are only required to identify the impacts before providing a service. It also raises the following concerns:

- Although SMEs are excluded from banks' value chains, we disagree with the proposal that where measures to verify compliance are carried out in relation to SMEs, the company shall bear the cost of the independent third-party verification. This proposal will create a significant competitive disadvantage for SMEs vis-à-vis larger companies acting also as suppliers, as will the requirement to provide targeted support to SMEs.

- How would the requirements work in case of several financial institutions (syndicated loans) or in case of adverse impacts during the contractual relationship. In a syndicate, it should be allowed to rely on actions taken by a lead syndicate member, if the taking of such actions for the syndicate is documented in a syndicate agreement.
- What is the extent of "making necessary investments" or "of collaboration with other entities"? Bearing in mind that breach of these provisions will entail civil liability for the bank. Therefore, "*make necessary investments, such as into management or production processes and infrastructures, to comply with paragraph 1*" should be replaced by "*establish appropriate processes and procedures to comply with paragraph 1*".
- The proposal lays out that if an adverse impact cannot be ended or minimized then a company shall refrain from entering into new or extending existing relations with the partner in question. Would that mean that if a company that had an adverse impact would not be able to access credit anymore, perhaps ever? As the adverse impacts can differ in severity and also happen when the company is acting in good faith, it seems like a disproportionate risk for the company.
- In order not to terminate a contract as provided for in Articles 7 and 8, it is not clear how to prove a "substantial prejudice" to the beneficiary.
- Finally, the application of "contractual assurances" mechanisms should be clarified. More precisely, how will they apply to ongoing contracts (remediation mechanisms)?

Finally, impacts cannot be prevented or mitigated before they have been identified. Therefore, it is unreasonable to require prevention or mitigation measures to impacts that should have been identified, and especially to base any civil liability based on this hypothetical concept.

VIII. Code of conduct (Article 7 & 8)

A 'code of conduct' check is imposed on the value chain.

We are concerned about the ability to impose these codes of conduct on clients (including from a contractual point of view). This could mean for the customer a multitude of codes of conduct to respect (depending on number of the bank it deals with). At the same time, it means that we will also have to apply those of our partners as part of the value chain (e.g. the credit institution could be seen as a supplier for certain services such as consulting).

As it is simply not possible to establish a compliance system with respect to hundreds of business partners, we recommend that the Commission could develop a standardized set of principles which could serve as a basis to comply.

Article 7 imposes obligations which from a commercial perspective are simply not reasonable, or pragmatic. 2(a) obligations detailed up to the last sentence are reasonable, but beyond that point, the obligations become too onerous. As part of the steps understood in the previous part of 2(a), the Business Partner would need to confirm what steps it could take reasonably, but circumstances will always vary and direct communication with impacted stakeholders is not always going to be necessary or realistic.

The need to get adherence to a code of conduct, or a prevention plan, in circumstances where contractual terms have already been agreed is simply not realistic.

Article 7(4) needs a review. There is no difference between obtaining contractual assurances and entering into a contract, so more clarity is needed to explain what this provision is seeking to achieve. The requirement to verify compliance shifts the burden of supervision from the competent authorities to private companies – which is neither appropriate nor acceptable.

Article 7(5) also needs a review. It is not clear how MS would implement measures to enable companies to terminate contractual obligations. The concept invites a host of problems.

IX. Bringing actual adverse impacts to an end (Article 8)

Article 8 creates potentially very onerous obligations. It seems unreasonable to pass the cost of change (rectification) to EU entities alone. Rectifying adverse impacts is potentially complex and far reaching, and perhaps should be driven at the public sector level based on political discussion.

X. Complaints procedure (Article 9)

The Directive should allow for the use of existing complaints procedures, such as those established under Directive 2019/1937 and the National Contact Points for Responsible Business Conduct under the OECD Guidelines for Multinational Enterprises.

Furthermore, the legal standing to submit a complaint seems very broad (encompassing potential affected persons, trade unions and other workers representatives and civil organisations), which could also have the collateral effect of encouraging complaints.

Concerning paragraph 9.4 it should be clarified that it should be the company that can decide with which complainants it will meet or not, as there can be various arguments why such meeting is not opportune (e.g. because of a pending court case with the same party, the party's complaint being addressed to the wrong company, the complaint being frivolous etc).

XI. Accompanying measures (Article 14)

We appreciate that the proposed Directive recognizes the value in industry cooperation, industry schemes and multi-stakeholder initiatives in due diligence and we fully support the proposal that Member States shall set up and operate individually or jointly dedicated websites, platforms or portals to help companies fulfil their obligations. However, the legal significance of article 14(2) is unclear as Member States are already allowed to support SMEs within the EU State aid framework and we understand that the current state aid rules continue to apply. We also highlight that the proposed delegated powers of the Commission need to be clear to ensure that the Commission cannot lay down additional obligation for companies.

XII. Combating climate change (Article 15)

This transition plan requirement could complement and be aligned to the same requirement in the CSRD, which is limited to the plan reporting. However, the CSRD instructs to specify by delegated acts the information to be included in the transition plan, while this directive remains general. This directive should refer to the CSRD and avoid new or contradictory requirements.

Due diligence processes with banks' clients should be focused on a specific list of sectors and following the timeframe proposed by the Net Zero Banking Alliance, while being aligned with the provisions that will be included under the CSRD and any other relevant legislation.

Renumeration policies are a matter between the owners and managers of an undertaking. The possibilities of shareholders to influence a company's renumeration policy has already recently been increased through Directive 2017/828. Therefore, we consider the inclusion of the issue of renumeration in this Directive to be unnecessary.

XIII. Supervisory Authorities (Articles 18)

We disagree with the fact that the supervisory authorities have the power to impose penalties based on the company's turnover and defined by the Member States, which could lead to differing national regulations.

The calculation of the maximum amount of the penalty should be clearly defined in the Directive.

XIV. Sanctions (Article 20)

We disagree that pecuniary sanctions are based on the company's turnover.

Furthermore, it should be clearly stated how the sanctions for companies that are subject to the Directive but registered in third countries would be managed. Who and how could sanction those companies?

Finally, it is to be noted that financial compensation is not and should not be the only form of remedy.

XV. Civil liability (Article 22)

We strongly oppose the inclusion of the proposed provisions on civil liability (article 22) and the payment of damages to affected groups (article 8) in the Directive. They go against the established principles of national civil law and create an unaccountable and uncertain legal risk for companies, which might go against the objectives of the Directive. We believe that the powers granted to the supervisory authorities without civil liability would be sufficient for the effective enforcement of the Directive.

First of all, the extent of civil liability is very difficult to ascertain as the Directive does not set out a clear definition of damage, or of sufficient due diligence measures, or establish a cause and effect between the damage and the failure to meet due diligence requirements. In addition, the definitions of the value chain and the established business relationship are not clear enough to bring legal certainty which business partners the company would be liable for.

Second of all, the damages are not adequately predictable. The Directive does not provide objective criteria to establish the amount of damages to be paid and how they will paid or how the damages are to be divided between them or between the companies in the value chain of the company that caused the actual damage. There also is no centralized body to co-ordinate multiple payments of damages by various companies to the same affected group, which likely to result in difficult and costly disputes, often in third countries.

Third of all, the provisions for civil liability seem to go beyond what is currently required by the UNGPs. A company should not be required to remediate for adverse impacts that the company has not caused or contributed to, even if they are directly linked to its operations. It should also be noted that financial compensation should not be the only form of remedy when neutralizing adverse impacts.

Should the provisions for civil liability be retained in the Directive, these concerns should be resolved. It should be clarified that the primary responsibility to pay damages rests with the company causing the damage. It will also be necessary to ensure that national laws continue to apply, in terms of civil liability (i.e. that we retain our specificities: fault/prejudice/causation link + obligation to demonstrate an interest in acting to engage the liability of a corporate officer). It would be appropriate to introduce the notion of materiality of the damage to avoid excessive judicialization.

The only exemption provided for is the one contemplated under article 22.2 that should be clarified. In particular, to what extent payments resulting from Article 8 (e.g. investments made under Article 8.3.(d) and (e)) will be taken into account in order to reduce the extent of a possible liability for damages? Moreover, the extent of a company's liability for impacts caused by a partner are not clear (e.g. could a company be held liable for all damages caused by a direct/indirect partner?). Would the bank need to pay for damages first and then claim those damages from the affiliate or partner?

There should be an additional exemption if the company has obtained an independent third-party verification confirming that it has applied appropriate measures.

Finally, according to article 22(3), subsidiaries of the companies in scope could also be held liable. However, other articles of this proposal only refer to the companies in scope and not to the subsidiaries thereof. We assume that this is intentional, however we would favour a clarification. In any case, a director shall only be responsible for a violation of his/her own obligations.

XVI. Duty of care (Articles 25)

Sustainable matters should be considered in the directors making decisions but avoiding any reference to Director duties and especially to the "duty of care" as it has not been harmonized at EU level and Member States have different legal frameworks. Introducing new elements to director's duty of care at EU level should only be considered with caution.

In addition, sustainability matters are not clearly defined, as well as such general application as "including in the short, medium and long term", going beyond the Directive's core substance on due diligence. This would create legal uncertainty, possibly making the duty uninsurable.

XVII. Setting up and overseeing due diligence (Articles 26)

There is a lack of clarity on the definitions of "director" and "board of directors" detailed in article 3 and the specific positions that shall be identified with such terms. In this regard, "directors" seems to include both the members of the board of directors and senior managers (as this term is defined in article 3 of Directive 2013/36/EU), while the Board of Directors is only overseeing it.

Also, the reference in Art. 26 to input from "stakeholders" and "civil society organisation" appears questionable. Some stakeholders and civil society organisations may focus on certain specific sustainability aspects only without considering the interests of other stakeholders or the economic impact and the side effects on companies. It should be clear that it is up to the company to define who its relevant stakeholders are and it is for the company to decide how to respond to their input. The definition and prioritisation of the potential stakeholders shall remain firmly among the Director (CEO) direct duties.

Concerning article 26.2, we acknowledge that this Directive would bring obligations to companies to prevent and bring to an end adverse impact, as well as concerning procedures on complaints. However, these future legal mandatory provisions should not be confused with the necessary leeway that companies must have in defining and executing their corporate strategy, within the boundaries of the applicable regulation (such as the one that may derive from this Directive). Therefore article 26.2 should be deleted.

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