

## INVESTOR STATEMENT OF SUPPORT FOR AN AMBITIOUS AND EFFECTIVE EUROPEAN DIRECTIVE ON CORPORATE SUSTAINABILITY DUE DILIGENCE

X November 2022

The Principles for Responsible Investment, Eurosif, Investor Alliance for Human Rights<sup>1</sup>, and X undersigned signatories (representing approximately X trillion USD in AUM) welcome the European Commission's [proposal](#) for a directive on corporate sustainability due diligence (CSDD) and its aim to anchor human rights and environmental considerations in companies' operations and corporate governance.

The CSDD proposal moves beyond the disclosure requirements under the Sustainable Finance Disclosure Regulation (SFDR) and Corporate Sustainability Reporting Directive (CSRD), to mandate financial and non-financial companies to carry out effective due diligence, set climate targets and transition plans, and to link executive remuneration with sustainability performance. This will be a transformative step forward to ensure that economic activities tied to the EU single market are conducted in a responsible manner.

However, improvements are needed to ensure a positive impact throughout the value chain, increase coherence with the EU sustainable finance framework, and to enable investors to better manage their own exposure to sustainability issues. In this statement we raise five key recommendations for EU co-legislators to create an ambitious and effective directive, for both financial and non-financial companies, aligned with EU sustainability goals, the EU sustainable finance framework, and international standards including the UN Guiding Principles on Business and Human Rights (UNGPs) and OECD Guidelines for Multinational Enterprises.

### 1. Require robust, ongoing due diligence from financial and non-financial companies, throughout the value chain

Carrying out effective due diligence, in line with international standards, [helps investors](#) to better manage financial risks, more effectively and proactively manage ESG impacts, and align their activities with the evolving demands of beneficiaries and clients. Some investor due diligence-related requirements already exist in EU legislation. For example, under the SFDR, investors have to *disclose* information relating to the aspects of their due diligence practices for certain investment activities, and under the 2021 delegated acts, [AIFMs](#) and [UCITS](#) must *consider* sustainability risks and "principle adverse impacts" (if they are considered under SFDR) when ensuring a "high level of diligence in the selection and ongoing monitoring of investments". However, none of these pieces of legislation mandate comprehensive investor due diligence, in line with the UNGPs and OECD Guidelines.

The CSDD proposal offers an opportunity to complement the existing EU legislation by filling in the gaps. To that end, investors call on the EU co-legislators to amend the due diligence obligations for financial undertakings to include ongoing assessments which cover the entire value chain, accompanied by guidance clarifying how different financial undertakings should interpret their responsibilities. This requires amending the EU Commission's proposal which currently limits financial undertakings' due diligence obligations to a pre-service assessment, and furthermore considers only the activities of the clients receiving the investment<sup>2</sup> provided those clients are not SMEs. Responsible investors are committed to carrying out ongoing due diligence, throughout the value chain, and this should be reflected in the CSDD. This will create a level-playing field and enable investors to better manage the ESG risks and impacts of their investments.

Finally, co-legislators must also ensure the requirement for non-financial companies to conduct due diligence throughout the value chain remains intact. In both cases, accountability and penalties should be based on the concepts of "causing", "contributing" and "linked to" as laid out in the UNGPs.

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<sup>1</sup> This letter was developed in collaboration with a number of PRI, Eurosif and IAHR members, but does not necessarily represent the views of the entire membership, either individually or collectively.

<sup>2</sup> The activities of other companies belonging to the same group are also considered if they are linked to the contract in question.

## **2. Broaden the personal scope of EU financial and non-financial companies under the directive, in line with the CSRD**

The scope of the Commission's proposal is insufficient and could pose risks and challenges for investors. Sustainability risks and adverse impacts, if not identified and not addressed, may lead to widespread and profound financial impacts on companies and their operations notwithstanding their size. It is also increasingly important, given the urgency of the climate transition, that more companies set climate targets and implement effective transition plans.

Co-legislators should introduce a clear timeline for increasing the scope of financial and non-financial companies subject to the CSDD, which is [sequenced in line with the CSRD](#). This would bring the CSDD into closer alignment with international guidelines, complement the disclosure obligations under CSRD and the narrative timeframe would bring clarity and certainty to other undertakings. Requirements should be proportionate to the capacity of the undertaking as clarified in the OECD Guidance and UNGPs, to ensure meaningful and effective due diligence.

## **3. Ensure directors have responsibility and oversight of due diligence requirements, climate targets, and transition plans**

While we welcome the intention with regards to directors' duty of care and oversight of due diligence processes, the language used is vague and does not provide sufficiently clear direction to lead to effective, harmonised duties throughout the EU.

The obligations on directors should be further specified in the directive so that they are responsible for ensuring the company implements adequate due diligence measures, and for approving the company's strategy including targets and transition plans. Without directors' responsibility for climate strategy and targets, business climate action will be insufficient to align with the EU Green Deal and Paris Agreement.

## **4. Strengthen the link between directors' variable remuneration and sustainability performance**

By focussing only on climate change mitigation objectives, and companies where "variable remuneration is [already] linked to the contribution of a director to the company's business strategy and long-term interests and sustainability", the effectiveness of Article 15(3) is significantly diminished. It also disregards the importance of other sustainability factors, the interconnectedness between environmental, social and governance (ESG) issues and could lead to [incoherencies](#) with reporting under the CSRD.

Co-legislators should ensure the CSDD proposal clearly mandates the incorporation of sustainability factors into director's variable remuneration by removing the conditionality of Article 15(3). Boards should be given the discretion to select relevant E, S and/or G factors and the appropriate balance of these factors in the remuneration package. This would allow companies to focus on the sustainability metrics most material to them, including climate, while also enabling progress across different sustainability goals.

## **5. Strengthen requirements on transition plans and increase alignment with CSRD**

Article 15 of the proposal requires very large companies to adopt a transition plan, but it does not provide a description on how this should be done, what the standards should be, and who is responsible for monitoring its implementation. Co-legislators should require undertakings in scope to set emission reduction targets and to meet specific actions and resource allocations to achieve such targets in order to align with the Paris Agreement. It must also be clarified that this plan should identify how to address Scope 1, 2, and 3 emissions. This should be completely aligned with, and match the granularity of, the transition plan disclosures under the European Sustainability Reporting Standards (ESRS) (once finalised) to create a clear, comparable and enforceable approach. This amendment would help investors verify the feasibility/likelihood of anticipated future resilience and sustainability performance improvements, better engage companies and track progress.

**SIGNATORIES**

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