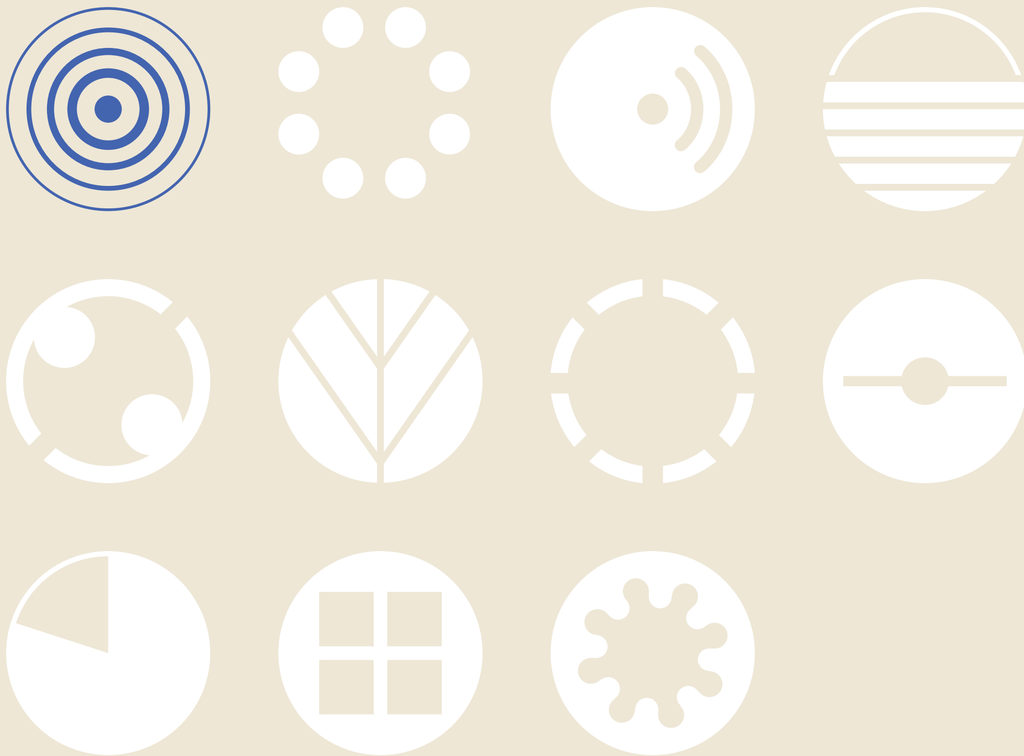


EC Directive on Corporate Sustainability Due Diligence (CSDD)

Consultation

Feedback

Dutch Banking Association

Introduction

The NVB underlines the importance of corporate social responsibility and, against that background, the introduction of the directive on Corporate Sustainability Due Diligence (CSDD). The Dutch financial industry, in accordance with current regulations and soft law, established practices for due diligence on business relationships and risk management processes. The NVB supports the introduction of a 'due diligence obligation' that is binding on companies and makes companies more aware of the (potential) adverse human rights and environmental adverse impacts of their activities and to act on it. Regulation at EU level is desirable as companies generally rely on global value chains. An international approach will have a bigger impact and will allow for the opportunity to create a level playing field among companies.

In line with the input provided in the earlier consultation round [1], the NVB welcomes this new proposal (the 'Proposal'). As will be set out below, however, the NVB still believes that in order to meet the objectives of the CSDD Directive, it should be better aligned with the OECD Guidelines for Multinational Enterprises (OECD Guidelines) including the UN Guiding Principles on Business and Human Rights (UNGPs) and with existing and prospective European regulations. Notably, the extent of the due diligence obligation in the CSDD should be consistent with the OECD Guidelines, allow the same risk based approach and limit liability to adverse impact 'caused by' a company or to clear cases where a company 'contributed to' such impact (this is further elaborated under section 3).

As set out in the advice of the Dutch Social and Economic Council [2], the OECD Guidelines and the UNGPs provide companies with guidance, which is further specified through o.a. sector guidance. Nevertheless, it is still not always clear when a company has done enough to prevent negative impact in the supply chain and further clarification is needed. The Proposal should therefore focus on learning and support for companies. The supervisory framework should foster positive impact and collaboration. Enforcement on the quality of due diligence steps is only possible after clarity has been given to companies covered by the due diligence legislation on what is expected and these companies have had sufficient time to implement the expected actions.

Lastly, the NVB finds it very important that a company's climate obligations under Article 15 of the Proposal will be significantly clarified.

1 Dutch banks support the proposal for EU legislation on supply chain due diligence (nvb.nl)
2 Effective European due diligence legislation for sustainable supply chains (ser.nl)

Key messages

1 Extent of mandatory due diligence requirement

a Desired alignment with UNGPs and OECD-Guidelines

The NVB observes that the Proposal specifically addresses financial undertakings and caters for a limitation of the due diligence obligations in view of the specific nature of a financial undertaking.

The NVB further notes that the Proposal introduces a scope that is only partly aligned with other EU legislation or the relevant international standards (UNGPs and OECD Guidelines).

The NVB proposes to align the scope of the due diligence obligation with existing legislation and best practices, as laid down in the UNGPs, OECD Guidelines and sector-specific OECD Guidance documents. Alignment with the UNGPs and OECD Guidelines would improve the clarity and uniformity of sustainability due diligence requirements in general and would correspond with the sector-specific due diligence guidance that banks in the Netherlands have already been using. The NVB is well aware that alignment with the UNGPs and OECD Guidelines entails a wider due diligence obligation for financial undertakings than is currently included in the Proposal. This is acceptable if the whole Proposal is made consistent with the OECD Guidelines in view of the risk based approach, prioritizing the most severe impacts and a focus on learning and support for companies and liability should be limited to adverse impact ‘caused by’ a company or to clear cases where a company ‘contributed to’ such impact as will be further discussed below.

We note in this regard that the NVB finds it important that in addition to alignment with the OECD Guidelines enforcement on the quality of due diligence steps can only become relevant after clarity has been given to companies covered by the due diligence legislation on what is expected and these companies have had sufficient time to implement the expected actions.

b Issues due to lack of alignment with UNGPs and OECD Guidelines

In the absence of full alignment with the UNGPs and OECD Guidelines, the NVB finds that it is insufficiently clear how the requirements of the CSDD currently relate to these guidelines, and thus how these principles should be applied.

Some examples

1 While Articles 5-11 of the CSDD impose due diligence requirements on qualifying companies, the material scope of the due diligence requirements lack clarity and is significantly limited by several definitions and limitations throughout the CSDD, as compared to the UNGPs and OECD Guidelines:

- The definition of 'value chain' of Article 3(g) limits the due diligence obligations for financial undertakings to 'the activities of the clients (...) and of other companies belonging to the same group whose activities are linked to the contract in question'. This definition excludes risks arising in the value chain of clients of financial undertakings and is therefore more limited than scope of the UNGPs and OECD Guidelines. Moreover, it is unclear what is meant with 'group' or with 'linked to the contract'.
- The definition of an 'established business relationship' in article 3(f) is defined as a 'business relationship, whether direct or indirect, which is, or which is expected to be lasting, in view of its intensity or duration and which does not represent a negligible or merely ancillary part of the value chain'. The NVB is concerned that, for example, the definition of 'established business relationship' removes some high-risk sectors from the scope of the due diligence requirements, which does not seem to be in line with the objectives of the CSDD. Banks or their clients or suppliers may also hold business relationships that are not expected to be lasting. They may also be aware of parts within the value chain that are ancillary, but may nevertheless relate to a high-risk sector which might need to be included in the due diligence obligation. The definition also contains several undefined concepts, which leave room for divergence in the absence of further guidance. Most notably, it is not specified when a business relationship, 'in view of its intensity or duration', can be regarded as 'expected to be lasting', which will have to be assessed in the pre-contractual phase. Thresholds regarding the intensity and duration of the relationship are lacking. It is also not clear when a business relationship is or is not 'a negligible or merely ancillary part of the value chain'. Finally, it is unclear whether the concept 'business relationship' should be interpreted in line with the meaning of that concept under the OECD Guidelines (or sector-specific guidance).
- The OECD Guidelines and UNGPs distinguish between adverse impact 'caused by', 'contributed to' or 'directly linked to' business operations. This spectrum indicates the involvement of a company with the adverse impact and the manner in which they are expected to address it, including remedy. This framework is absent from the Proposal, which – in the opinion of the NVB – is a missed opportunity to align current best practices with the CSDD due diligence obligation, as well as the redress and remediation regime (see also under Redress and Remediation).
- The due diligence obligations under the CSDD are limited to the pre-contractual phase for financial undertakings, which is not aligned with the due diligence requirement under, for example the SFDR (and the UNGPs or OECD-Guidelines).

In its current form the Proposal risks introducing another layer of complexity, as it does not use the same concepts and terminology as used in the frameworks already applied by many financial undertakings. This adds to the (administrative) burden of financial undertakings and unnecessarily reduces the scope of the due diligence responsibilities of financial undertakings.

c Alignment with existing legislation for the financial sector

General remarks

The NVB finds it key that all proposals that form part of the wider Sustainable Finance Action Plan and The road to finance the Green Deal should be aligned in a way that the same definitions, terminology, scope and concepts are used as much as possible, and are aligned both in interpretation as well as in terms of the timing of implementation. Reporting standards (Taxonomy, SFDR and CSRD) have been developed prior to the CSDD. The reporting by other companies pursuant to these reporting standards will (along with other sources) provide input for a company performing due diligence pursuant to the CSDD. It also works the other way around: due diligence performed pursuant to the CSDD will in turn provide input for the reporting obligations under aforementioned reporting standards. For that reason alone there should exist consistency between these rules, as well as clarity how these rules interrelate. Even though the Explanatory Memorandum of the Proposal mentions these reporting standards, it is not clear how the obligations under these different regulations interact.

Examples

1. The due diligence requirements under the SFDR and the CSDD feed into the CSRD reporting requirements. The due diligence standards are not the same and the proposal is not clear on how they interrelate. Applying various due diligence standards as input for reporting requirements is complex and may lead to inconsistencies;
2. Banks have already made significant efforts in the context of SFDR and Taxonomy to assess their entities and portfolios on (quantitative) sustainability factors. Therefore, and in order to prevent divergent approaches among different banks, it would be useful to receive guidance on the relationship of the CSDD with, for example, the SFDR's Principal Adverse Impacts (PAI) statement, and/or the definitions and/or Green Asset Ratio (GAR) of the Taxonomy Regulation;
3. The relationship between the CSDD due diligence and the due diligence required by the minimum safeguards of Article 18 Taxonomy Regulation should be clarified in order to prevent divergent applications;
4. In view of the specific definition of 'established business relation' and the requirement to perform due diligence only before providing financial services, the NVB would welcome clarification how this definition or concept differs to establishing a 'business relation' under the anti-money laundering legislation;
5. With regard to article 15 of the Proposal, the NVB notes that financial institutions are already subject to rules on variable remuneration as implemented in the CRD, EBA Guidelines on sound remuneration policies and national legislation. A bank's variable remuneration policy must consider ESG risks when setting its policy and setting for example performance criteria. In addition, the SFDR requires disclosure on how ESG related risks are considered in the remuneration policy of institutions in scope of the SFDR. The NVB requests clarity on how article 15 of the Proposal impacts the existing variable remuneration requirements applicable to financial institutions.

2 The importance of a harmonized and coordinated approach regarding climate change

The financial sector is willing and able to play an encouraging and supporting role in combating climate change. Various banks have now joined the Net-Zero Banking Alliance. This international cooperative agreement represents trillions in assets and, collectively, aims to combat the emission of greenhouse gasses to limit global warming to 1,5 degrees. The NVB supports the inclusion of combating climate change within the scope of the CSDD. However, the NVB has serious concerns as to how the issue of climate change is currently featured in the Proposal.

Article 15 of the Proposal entails an obligation to adopt a plan to ensure that the strategy of a company is compatible with the transition to a sustainable economy and with the limiting global warming to 1,5 C in line with the Paris Agreement. However, this obligation is not embedded in the due diligence obligations set out in Article 7 and 8 of the CSDD, and, as such, is not covered by Article 22. This obligation therefore remains out of scope of the harmonized civil liability regime. The NVB believes it is essential that the Proposal specifically addresses this interrelationship (either by specifying there is no civil liability in this respect or by setting out clearly when the absence or defects in a climate strategy lead to civil liability). The NVB finds it important to confirm that banks already have made a variety of climate commitments and UNEP-FI plays an important role in providing an internationally coherent framework and guidelines. The obligations in relation to article 15 should be aligned as much as possible with these international practices. The NVB notes that separating combating climate change from the redress and remediation regime in the CSDD risks limited compliance with this provision. This leads to an enhanced risk of divergent application within national legal systems, jeopardizing a level playing field.

There is not one single strategy or road to limit global warming to 1,5 degrees. Article 15 of the Proposal should therefore provide guidance (per sector and/or type of activity) to clarify when a climate strategy is compliant with Article 15 of the Proposal. Without clear benchmarks or methodologies due diligence on the climate strategy will be difficult if not impossible and will certainly lead to different assessments of a company's strategy by the many companies in its value chain that have to perform due diligence on the same company.

If the obligation in Article 15 is to be maintained as is, it is essential that it will be made more specific and that it reflects the realism that companies, including financial undertakings, in spite of their best efforts, may be constrained by political choices, geopolitical developments, customer demand and various other factors that influence the speed of transition towards a carbon neutral economy. In the absence of further specification and guidance, the divergent application of Article 15 by Member States' civil courts is likely, inevitably leading to an unlevel playing field and (increased) forum shopping within the European Union.

3 Redress and remediation

A primary objective of the Proposal is to ensure the implementation of effective prevention and mitigation processes for adverse human rights and environmental impacts by entities covered by the CSDD. By definition, these processes will differ, depending on the company and its supply chain. These processes will also (have to) evolve with time, as new insights, technologies and best practices emerge. As a result, the NVB appreciates that the CSDD cannot exhaustively set out the due diligence responsibilities of companies, including financial undertakings, and that open standards (per the Scope set out under 1) are, to some extent, inevitable. The NVB strongly believes that the dynamic nature of a company's due diligence responsibilities should be reflected in the compliance and remediation regime as laid down in the Proposal.

The current regime – consisting of sanctions and civil liability – is adversarial rather than focused on cooperation and 'punishes' companies and directors for a failure to comply with ever-evolving due diligence practices. As it stands, the NVB believes that the redress and remediation regime has a number of undesirable side effects and does not ensure the implementation of effective due diligence processes:

1. In Article 22, the Proposal introduces a civil liability regime with respect to a company's failure to (1) prevent potential adverse impacts (article 7 of the Proposal) and/or (2) bring actual adverse impacts to an end (article 8 of the Proposal). The proposed civil liability regime aims to distinguish between harm occurring in a 'company's own operations, at the level of its subsidiaries and at the level of direct and indirect business relations in the value chain' [3]. This distinction regarding the degree of a company's involvement with the adverse impact does not appear to have made its way into Article 22. Only indirect established business relationships appear to be addressed in Article 22 (2). What is more, it remains unclear how a financial undertaking can establish a business relationship with an indirect partner and how that relates to the limited scope of the value chain as defined in the Proposal in respect of financial institutions. As it stands, the link between a company's responsibilities under articles 7 and 8, its involvement with the adverse impact and its liability under Article 22 is unclear and the litigation risk is potentially extensive.
2. This lack of clarity can be counterproductive. As a result, companies may not dare to embark on an (often long-term) process to address wrongdoing in their clients' value chain. This may incite de-risking and divesting, at the expense of engaging with (prospective) clients to achieve the desired impact. For example, a bank may refuse or discontinue funding to clients with activities in emerging markets, as the liability risk is deemed too substantial (see also under 3 below). Banks will be put in the difficult position to assess, prior to inception of the contract, whether potential or actual adverse may occur in their client's value chain, risking an unclear exposure to liability when they get it wrong. This context is not conducive to the implementation of effective due diligence processes by financial undertakings.
3. The due diligence obligations in Articles 7 and 8 focus on structural elements that should prevent and mitigate adverse impacts. In Article 8, only section 3(b) and 3(c) appear to touch upon the central role of engagement with business relations in order to

3 Proposal, p. 13.

mitigate adverse impacts (notably the development and implementation of a corrective action plan). For financial undertakings, engagement with clients is crucial to be able to address adverse impacts. The Proposal prescribes suspending or terminating a relationship to the extent the actual adverse impacts cannot be minimized or brought to an end (Article 8 section 6). Although Article 8, section 7, contains a specific derogation acknowledging the dilemma financial institutions face, the Proposal does not sufficiently reflect 1) the central role of 'engagement' with clients as an effective instrument to address adverse impacts in the value chain, 2) the realism that engagement may be a long and difficult process facing various local constraints and 3) the absence of alternatives to entering into a step by step process. At the same time, Article 8, Section 7, in connection with Article 22, does not clearly provide for a limitation of potential liability towards clients and third parties if financial services are continued.

4. Private enforcement of the proposed due diligence obligations and liability regime is not harmonized in the Proposal. Currently, the possibilities for collective redress in private liability lawsuits and the standing of NGO's greatly varies between the Member States. In combination with the considerable lack of clarity about the extent of obligations for companies, this entails a real danger that NGO's and other interested parties will gravitate towards more favorable jurisdictions within the EU, with a view to establish jurisdiction in those Member States anticipating a broader interpretation of the Proposals provisions. The NVB acknowledges that this is to some degree, inevitable. However, given the potentially very significant impact of the proposed liability regime, this further calls for significant clarifications to the proposed civil liability regime.

The NVB believes that the CSDD should strike a balance between clarity, efficiency and compliance. This balance could be achieved along the following lines:

1. International best practices: The NVB believes the Proposal should leverage, to the greatest extent possible, the international consensus that already exists with respect to responsible business conduct and due diligence. This means that also the civil liability regime and the demarcation of a company's involvement with the adverse impact should align with the definition inventory used in the OECD Guidelines and UNGPs. As said, these distinguish between adverse impact 'caused', 'contributed to' and 'directly linked to' a company's activities. This distinction does not shift responsibility, yet provides an opportunity to clarify when civil liability may arise allowing companies to better foresee and assess litigation risks. In addition, we would argue that by seeking close alignment on these international best practices, we could work towards an international level playing field as well as common understanding and application of equal standards.
2. Carve-out 'directly linked to': To the extent the scope of the mandatory due diligence responsibilities is extended in line with the UNGPs and OECD Guidelines, it is essential that the civil liability regime expressly excludes liability for damages on account of adverse impact that a company is 'directly linked to'. The NVB accepts that companies have a responsibility to address such impacts in line with the CSDD and we acknowledge our role as prescribed in the UNGPs, but the exposure to civil liability would be not be proportionate. Potential exposure to civil liability is also likely to have a 'chilling effect', rendering an extension of the scope as set out under 1a for financial undertakings ineffective. For the avoidance of doubt, the NVB supports a civil liability regime with respect to adverse impact that is 'caused' by companies and clear cases

where a company ‘contributed to’ such impact (within the meaning of the OECD Guidelines and UNGPs).

3 Learning environment: The dynamic nature of the due diligence responsibilities, in combination with the case-specific application (per client, business partner, activity) of the due diligence processes, creates a challenging regulatory environment for companies to navigate. For this reason, the NVB proposes, in line with the advice from the Dutch Social and Economic Council [4], the introduction of a centre of expertise, which provides a learning environment, providing forward-looking remediation in specific cases and serves as guidance to companies in similar cases [5]. It does not replace the OECD NCP or any other complaints mechanism, but aims to bridge the gap between a company’s internal complaints mechanism (per Article 9 of the Proposal) and a backward looking liability regime.

The proposed learning process would allow interested parties (such as those (potentially) affected by the adverse impact or civil society organizations) to request a remediation opinion from the committee regarding potential or actual adverse impact caused by, contributed to or directly linked to a company’s activities. The committee would consist of independent experts with sector specific expertise and, for example, a representative from the OECD. An independent chairperson would chair the committee and the members of the committee are to operate in an independent and impartial manner. The process would allow for submissions from the parties involved and would seek to come to a ruling in an impartial and independent manner.

This process could be especially valuable in establishing a company’s obligations in respect of its involvement with potential or actual adverse impact and provide actionable guidance. Decisions of the expert remediation committee would be publicly available (albeit anonymized for business sensitive information), allowing companies to apply this guidance going forward. It would not preclude civil liability proceedings for situations where the norm for the company involved was clear, where the impact was such that it should have been addressed in the company’s risk based due diligence, the company had sufficient time to apply the norm, yet still (continued to) cause or contribute to an adverse impact.

According to the NVB, a learning process would have a number of advantages. The remediation committee would be able to provide actionable sector-specific guidance, which will aid the implementation of the CSDD and the development of uniform best practices (creating a level playing field). As the remediation committee would have access to sector specific and/or country specific expertise (that courts in the Member States do not readily have access to) divergence in the interpretation and application of the CSDD would be minimized.

4 EU legislation to encourage sustainable supply chains | SER

5 The NVB notes that the “IMVO Dutch Banking Sector Agreement on international responsible business conduct regarding human rights” includes remediation mechanisms (notably the voluntary advisory expert mechanism) that bears resemblance to the proposed expert remediation committee. However, the mechanisms contained in the IMVO Agreement are of a largely self-regulatory nature and, for that reason, do not appear suitable, accessible remediation alternatives within the context of the CSDD.

Furthermore, the process would take considerably less time than civil liability proceedings. This allows companies to pivot their processes accordingly and ensures that the remediation process under the CSDD is responsive to new insights and developments. Moreover, it allows companies a reasonable 'learning curve' in respect of the implementation of open human rights norms referred to in the CSDD, which will encourage financial undertakings to remain engaged with their clients and their respective value chains.

Lastly and very importantly, the remediation committee would be accessible to NGO's even if they would not have standing in the courts of the Member States. This would not curtail the important role of NGO's in this field. On the contrary, it would provide an accessible, low cost alternative that is aimed at preventing future adverse impacts.

As such, a learning process provides significant efficiencies in addressing potential and actual adverse human rights and environmental impacts. This benefits companies and stakeholders alike and is in line with the EU Commission's broader focus on Alternative Dispute Resolution initiatives and the overarching goal of the CSDD to strive towards a climate-neutral and green economy and deliver on the UN Sustainable Development Goals.

The NVB appreciates that the introduction of a centre of expertise is to be properly embedded in the redress and remediation context of the CSDD and that the above may not cover all relevant aspects of this mechanism. The NVB welcomes the opportunity to further discuss this issue.

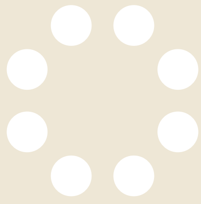
4 Engagement and emerging markets

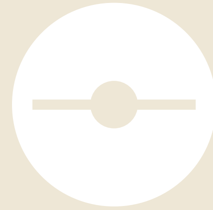
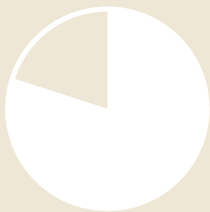
The NVB is of the opinion that the proposal should focus in more detail on the challenges related to engagement in emerging markets.

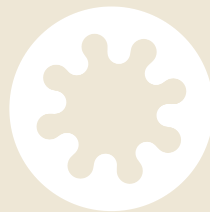
First, and further to point 2 (3) above, the Proposal appears to rely primarily on the use of contractual clauses, third-party verification and, where necessary, a prevention action plan as tools for engagement with the supply chain. The Proposal does not provide further guidance on engagement with stakeholders in the supply chain. This may lead to complex considerations in light of the inherent differences between sectors, supply chains and geographical locations. This holds true especially in the context of emerging markets, where the risk of adverse human rights and environmental impacts is more present. Consequently, and in the absence of guidance, companies may opt to disengage from emerging markets. In the financial sector, financial legislation (e.g. legislation protecting the clients of the bank) further complicates decision-making. These complexities and the room for risk-based decision-making should also be reflected in the obligation to end or suspend the business relationship of Article 7 and 8 of the Proposal.

Second, the focus on the contractual clauses and third-party verification as (only) tools for engagement will most likely not contribute towards achieving the goals of the proposal. In this respect, the NVB would also like to draw attention to the Report of the International Trade Center on this topic [6]. In order to effectively prevent adverse impacts, the NVB again stresses the importance of alignment with the OECD Guidelines and UNGP's on the topic of stakeholder engagement. These instruments set out various ways of risk based engagement with relevant stakeholders, in order to address the interests and concerns of these stakeholders in a meaningful and effective way.

6 Report of the International Trade Center.





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