

Date: 8 september 2022

Dutch Banking Association position on the ENVI report on the Deforestation Regulation

Introduction

The Dutch Banking Association (NVB) underlines the importance of combatting deforestation and banks are taking individual and collective action to address this challenge. The NVB supports the introduction of a due diligence obligation with the proposal for the EU Directive on Corporate Sustainability Due Diligence (CSDD), which makes companies more aware of the (potential) adverse human rights and environmental impacts of their activities and act to counter such impacts. The CSDD is a good step towards a European level playing field by regulating bottom line requirements. The NVB has taken note of the amendments to the deforestation regulation by the ENVI Committee and we would like to call upon the Members of the European Parliament to vote against the amendments concerning the financial institutions for the reasons explained in this paper.

Key messages

1. Harmonise due diligence requirements

The Dutch Banking Association (NVB) underlines the importance of corporate social responsibility and, against that background, supports the proposed Corporate Sustainability Due Diligence (CSDD)-Directive. In this context, the deforestation regulation would be helpful when it adds the subject-specific context and definitions, starting with a meaningful definition of deforestation. However, proposals for added deforestation due diligence requirements should be part of the proposed CSDD. This prevents the creation of an added layer of complexity and lessens the administrative burden for financial institutions. The requirements for due diligence, supervision, liability and sanctions in the deforestation regulation should be the same as the requirements in the CSDD. Harmonisation ought to be considered between existing and recognized certification schemes.

The amendments aim at adding elements that the EU-Taxonomy and CSDD omitted: “existing instruments such as the EU Taxonomy Regulation and the Corporate Sustainability Reporting Directive do not impose obligations on investors and banks to stop and prevent investments going towards harmful activities and provide no mechanisms to hold them accountable.” However, it is the aim of the CSDD “to foster sustainable and responsible corporate behaviour throughout global value chains.” The current provisions of the draft CSDD for financial institutions are indeed more limited than the proposed amendments. That is why the NVB, in response to the CSDD proposal, proposed 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 aware that alignment with the UNGPs and OECD Guidelines entails a wider due diligence obligation for financial undertakings than is currently included in the CSDD proposal. This is acceptable if the whole CSDD 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."¹

In other words, the amendments to the deforestation regulation would become redundant if the CSDD becomes aligned with the OECD Guidelines and the UNGPs. In that case a separate deforestation due diligence requirement would not be necessary since those requirements would be included in the CSDD. However, if this is not the case, an adequate link and consistent application of due diligence requirements, terminology, supervision, sanctions and liability should be made between the CSDD and the deforestation regulation. It is not feasible to live up to the different frameworks or perhaps adding an example where it is not in sync and explaining why that is an issue?

Additionally, preventing activities that cause human rights' violations are included in the amendments in general terms and not specifically related to deforestation, which is why we think that reference should be removed. The NVB emphasises that human rights harms should be prevented, also in the context of deforestation. We acknowledge that ideally the prevention of deforestation and of human rights' violations should go hand in hand, but if they do not, then the concept of do no significant harm should be applied to ensure that improvements in one sustainability dimension do not cause degradation in another dimension. However, if a general reference to human rights' violations stays it should focus specifically on the human rights' violations caused by deforestation, which should then be integrated throughout the document and specify what is meant by human rights violations linked to deforestation.

2. Proportionate liability

The NVB welcomes this new proposal, however we also believe that it should prioritize the most severe impacts and focus on learning possibilities and support for companies. As we described in our response to the CSDD, the following position applies:

'Liability should not include activities 'linked with' deforestation, since that would include the entire financial system, from companies to financial institutions to governments. Limiting it to adverse impact 'caused by' a company or to clear cases where a company 'contributed to' is the preferred wording. 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 acknowledges that companies have a responsibility to address deforestation related impacts in line with the CSDD and we acknowledge our role as prescribed in the UNGPs, but the exposure to civil liability would not be proportionate. As we stated in our response to the CSDD consultation:

Potential exposure to civil liability is also likely to have a 'chilling effect,' making an extension of the scope as set out under the 1a of the CSDD response of the NVB for financial undertakings ineffective. For the avoidance of doubt, the NVB supports a civil liability regime with respect to adverse impact 'caused' by companies and clear cases where a company 'contributed to' such impact (within the meaning of the OECD Guidelines and UNGPs).²

We would like to see a learning environment, as indicated in the response to the CSDD, the NVB proposes, in line with the advice from the Dutch Social and Economic Council, 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.'

3. Companies should have the burden of proof on deforestation

The NVB supports a strong system of checks by customs and other government authorities at the European borders to prevent goods that cause deforestation to enter the European market. The role of companies (including banks) is a different one and should be focused on due diligence in line with the UNGP / OECD Guidelines. Requiring financial institutions to provide proof does not fit in this system and would not work if it is only aimed at the financial institutions (where other (non-financial) companies do not have to provide such evidence).

In line with the OECD Guidelines, the due diligence requirement should not take away the responsibility from the party causing an adverse impact. The focus should therefore be on the starting point of the supply chain: the landowner. The deforestation regulation should set out a clear and uniform certification requirement for the landowner, which can be used by all parties in the supply chain in their deforestation due diligence. It should also specify whether such certification should be passed on to all parties in the supply chain, or whether parties further in the supply chain can rely on statements by their suppliers that they only source from landowners that have provided such certification. The NVB supports a strong system of checks by customs and other government authorities at the European borders to prevent goods that cause deforestation to enter the European market. The role of companies (including banks) is a different one and should be focused on due diligence in line with the UNGP / OECD Guidelines. Requiring financial institutions to provide proof does not fit in this system and would not work if it is only aimed at the financial institutions (where other (non-financial) companies do not have to provide such evidence).

The risk of the current proposal is that it requires company specific information, such as geolocation coordinates, which needs to be provided by the company in question and needs to be provided all the way through the supply chain. If this proposal would be accepted, the banks can have difficulty to access data, since each country has laws of data protection and companies may not be able to share the data with other parties in their supply chain, including the bank of such companies in the supply chain. The companies would depend on the landowner's authorization (and all other parties involved in the supply chain between the landowner and the company/bank) to share the data.

In addition, even if the landowner is able and willing to share such data with the many companies and their banks in its value chains, it would cause a major compliance burden on all parties involved: All parties have to comply with the trade secrets, confidentiality and data protection requirements of their own country, but also with the applicable requirements from the country of origin and of the countries of the parties in the value chain in between the country of origin and the relevant party.

Note: companies can have thousands and thousands of suppliers. To manage the coordination and processing of the data means that banks would need to develop internal resources (employees and systems) to monitor the financed company chains, which seems to be disproportionate due to the number of clients banks have and the size of the chains. In this sense, the best way for banks in the Netherlands to understand the potential exposure of its clients to deforestation risks is based on a landowner's certification and a declaration by other companies in the supply chain about its compliance with the due diligence requirements (which can be third-party verified or in line with the European authorities).

Every single company in a supply chain can be financed by multiple banks from Netherlands and Europe. This means that multiple due diligences would be done on the same scope, causing a huge bureaucracy. The deforestation regulation therefore has to contain clear and consistent expectations and requirements regarding due diligence, including the possibility for parties in a supply chain to rely on due diligence performed by others.

Another option that could be studied if this regulation would be approved in its current form, is to perform due diligence considering a minimum sample of companies (and not with all the financed companies), based on risk criteria. Rules should be defined to be feasible to be implemented.

4. **Look to narrow the scope of financial services included**

The scope of what 'financial service' means is broad. It includes payment services, which are irrelevant in the context of causing deforestation, but would add to the administrative burden on financial institutions when it is included in the scope. If the scope were to be expanded, it should be narrowed down to financial services with an actual impact on deforestation, meaning lending activities.