PRI STATEMENT: EUROPEAN COMMISSION PROPOSAL ON CORPORATE SUSTAINABILITY DUE DILIGENCE

London, 2nd March 2022

Last Wednesday 23rd February, the European Commission published its proposal for a Corporate Sustainability Due Diligence Directive (CSDD). This is a transformative step forward to ensure that economic activities tied to the EU single market are conducted in a responsible manner. The PRI responded to the initial public consultation from the European Commission on Sustainable Corporate Governance in February 2021.

The PRI welcomes the due diligence obligations, particularly where aligned with international standards as the UN Guiding Principles on Business and Human Rights (UNGPs) and the OECD Guidelines for Multinational Enterprises. There is a clear focus on harm reduction including consultation with stakeholders, collaboration with partners, capacity building in relation to SMEs and companies based outside the EU; and efforts to ensure accountability and consequence for non-compliance. This will support investor's sustainability assessments, enhance risk analysis and processes for impact mitigation, and provide greater understanding of company operations, throughout the value chain. It will enable responsible investors to conduct better-informed engagement with investees, to respect human rights and give due consideration to environmental issues.

However, to ensure a positive impact throughout the value chain, and to enable investors to better manage their own exposure to sustainability issues, some improvements will be needed.

- **Increased coherency between the CSDD and EU sustainable finance legislation is essential**

We welcome the Commission's efforts to align the CSDD with the broader EU sustainable finance framework. However, more clarity is needed on how the due diligence obligations under the CSDD will overlap with similar requirements under Article 4 of the SFDR. For example, under the CSDD proposal, financial undertakings' due diligence only requires pre-investment assessments. This is a deviation from the way that due diligence is understood in the SFDR, UNGPs and OECD guidelines, and means that investors while complying with CSDD rules still risk being called out for irresponsible behaviour via other regimes (for example OECD National Contact Points).

- **The scope of the file is insufficient and will leave gaps for investors**

Along with over 100 investors, companies, business associations and initiatives the PRI called on the Commission to introduce a mandatory due diligence proposal which included all businesses operating in the EU, regardless of sector or size. The limited scope of the Commission's proposal is insufficient and could pose risks and challenges for investors, particularly in private markets, when it comes to managing their exposure to sustainability issues.

- **Some language and terms should be clarified to avoid inconsistencies in transposition**

Some terms and phrases used in the proposal are ambiguous - for example, the definitions of "appropriate measures" or "established business relationships", which is a deviation from the UNGPs. This risks undermining one of the main aims of the proposal – to bring coherency in due diligence requirements across all Member States. Investors need confidence that no matter which Member State their company is operating in, they are meeting the ambition set out in the European Directive.

- **The coverage of whole value chain is necessary but co-legislators must be cautious about "contractual cascading"**

Co-legislators must consider how the use of contractual clauses would effectively allow for prevention and remediation of adverse impacts throughout value chains. This should involve an assessment of how contractual obligations would be understood (e.g. ensuring the focus is on risk to people/environment not risk to business), respected and implemented correctly throughout the value chain, including with regards to SMEs. The approach of using contractual clauses to ensure compliance throughout the value chain must not turn into a "tick box approach".

- **The articles relating to directors' duties should be reinforced**

Compared to the Commission's initial impact assessment, the coverage of director's duties in this proposal is extremely limited. This is a missed opportunity. Furthermore, while we welcome the intention with regards to directors' duty of care and oversight of due diligence processes, the language used in Articles 15, 25 and 26 is too high-level to lead to strong, harmonised duties throughout the EU.

- **The link between variable remuneration and sustainability performance must be strengthened**

We welcome the consideration of directors' remuneration in the Commission's proposal. However, 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 the requirement will be severely diminished. To balance the focus on short-term financial metrics in pay packages, the incorporation of ESG factors (beyond climate change mitigation alone) into director's remuneration should be properly mandated.

The Corporate Sustainability Due Diligence Directive has the potential to significantly change market practice for the better and provide investors with information and assurance to better manage sustainability impacts. The PRI welcomes this much-anticipated proposal and looks forward to continuing collaboration with co-legislators and signatories to bring in the responsible investor voice and ensure an ambitious and achievable proposal aligned with EU sustainability goals.

Quotes:

Elise Attal, Head of EU Policy: "*This proposal is an opportunity to better align the interests of companies, their shareholders, managers, stakeholders and society as a whole. A growing number of investor PRI signatories are seeking to better understand how companies consider sustainability issues and encourage a more holistic approach for the maximisation of social, environmental, as well as economic/financial performance. The PRI will continue engaging its signatories and dialogue with policy makers in the months ahead to make sure the proposal is ambitious enough and delivers its promises to help companies to address sustainability risks and to create opportunities for long-term value creation*".

Nikolaj Halkjaer Pedersen, Senior Lead, Human Rights: *"The European Commission proposal establishing a corporate sustainability due diligence duty is a transformative step forward to ensure that economic activities tied to the EU single market are conducted in a responsible manner. It strengthens the foundations on which other corporate and investors disclosure regimes are established which should have positive effects through value chains. It should lead to better and more appropriate information for investors to manage their own exposure to sustainability issues, such as human rights and environmental protection. The limited scope of companies covered, however, pose risks and challenges for investors - particularly in private markets - when it comes to managing their exposure to sustainability issues".*

ABOUT THE PRI

The Principles for Responsible Investment (PRI) is the world's leading proponent of responsible investment. Supported by the United Nations, it works to understand the investment implications of environmental, social and governance (ESG) factors and to support its international network of investor signatories in incorporating these factors into their investment and ownership decisions. The PRI acts in the long-term interests of its signatories, of the financial markets and economies in which they operate and ultimately of the environment and society as a whole. Launched in New York in 2006, the PRI has grown to more than 4,800 signatories, managing over $121 trillion AUM