Principles for Responsible Investment

PRI POSITION PAPER

EU CORPORATE SUSTAINABILITY DUE DILIGENCE (CSDD) DIRECTIVE

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INTRODUCTION

On 23rd February 2022, the European Commission adopted a proposal for a directive on Corporate Sustainability Due Diligence (CSDD). This would introduce an environmental and human rights due diligence duty for financial and non-financial companies within scope of the directive. It also proposes transition plan requirements for larger companies in scope and duties for the directors of the EU companies covered.

This position paper builds on PRI's consultation response (February 2021), reaction statement (March 2022), key takeaways from a joint PRI & WBA roundtable on CSDD with policymakers and signatories held on 13th June 2022, and signatory feedback received over August 2022. The PRI welcomes the proposal, but a number of improvements will be needed to make it an ambitious and efficient policy. In this paper we have decided to focus on key topics where PRI, in its unique position as a global investors' organisation, can bring added value to the discussion.

The paper is separated into recommendations and other key preliminary considerations that remain to be further explored in order to make precise recommendations or amendments. This paper will guide PRI's engagement with policymakers, aiming to bring in the responsible investor voice and ensure an ambitious and achievable directive aligned with EU sustainability goals.

ABOUT THE PRI

The Principles for Responsible Investment (PRI) is the world's leading initiative on responsible investment. The PRI has now over 5,000 signatories (pension funds, insurers, investment managers and service providers) to the PRI's six principles, representing US $121 trillion in assets under management.

The PRI supports its international network of signatories in implementing the Principles. As long-term investors acting in the best interests of their beneficiaries and clients, our signatories work to understand the contribution that environmental, social and governance (ESG) factors make to investment performance, the role that investment plays in broader financial markets and the impact that those investments have on the environment and society as a whole.

The PRI works to achieve this sustainable global financial system by encouraging adoption of the Principles and collaboration on their implementation; by fostering good governance, integrity and accountability; and by addressing obstacles to a sustainable financial system that lie within market practices, structures and regulation.

For more information, contact:

Elise Attal
Head of EU Policy
Elise.Attal@unpri.org

Hazell Ransome
Senior Policy Analyst, EU
Hazell.Ransome@unpri.org

DUE DILIGENCE RECOMMENDATIONS

The PRI welcomes the due diligence obligations placed on financial[1] and non-financial undertakings under the proposed CSDD, particularly where aligned with international standards, namely 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 by way of consultation with stakeholders, collaboration with partners, capacity building in relation to SMEs and companies based outside the EU, and efforts to ensure accountability for non-compliance. The proposal will support investor's sustainability assessments; enhance risk analysis and processes for impact prevention, mitigation and remediation; and provide greater understanding of those companies within scope of the CSDD including throughout the value chain. It will also enable responsible investors to conduct better-informed engagement with investees, to respect human rights and give due consideration to environmental issues.

We also welcome the Commission's efforts to align the CSDD with the broader EU sustainable finance framework such as the SFDR, minimum safeguards of the Taxonomy Regulation and CSRD. However, there are areas where there could be increased alignment with both fields.

- **Remove the pre-service limitation to investor due diligence to include ongoing assessments, throughout the value chain, in line with international standards**

Under the CSDD proposal, financial undertakings are only obliged to carry out due diligence assessments before providing a financial service[2]. In addition, this pre-service assessment only considers the activities of the clients receiving the investment (and of other companies belonging to the same group whose activities are linked to the contract in question) meaning there are no value chain due diligence obligations. Furthermore, this pre-service provision due diligence obligation does not include SMEs receiving the financial service[3].

These restrictions are a deviation from the way that due diligence is understood in the SFDR, AIFM, UCITS[4] and international standards, and pose a risk for investors because they could:

- Lead to severe sustainability risks and impacts being unidentified - given that the most severe risks and impacts are not necessarily found in the largest companies (the opposite is often the case).
- Weaken investor leverage with companies and internally, when trying to make the argument that ongoing and post-investment due diligence is something that should be, and as we document below increasingly is being, done.

[1] See PRI's 2020 paper "*Why And How Investors Should Act On Human Rights*". Just as for all businesses, institutional investors have a responsibility to respect human rights. Leading investors also recognise that meeting international standards – and preventing and mitigating actual and potential negative outcomes for people – leads to better financial risk management and helps to align their activities with the evolving demands of beneficiaries, clients and regulators.

[2] See Article 6(3) of the CSDD proposal.

[3] See Article 3(g) of the CSDD proposal.

[4] Under Article 4 of the SFDR (Regulation (EU) 2019/2088), investors are required to consider the principal adverse impacts (PAIs) of their investment decisions and to publish and maintain a due diligence statement. This statement must include a description of the actions taken to address adverse impacts, including a description of engagement policies with investees where applicable. Investors must also provide a reference to their adherence to internationally recognised standards for due diligence. Furthermore, under Article 1(7) and Article 1(2) of the delegated acts amending UCITS and AIFM from April 2021 respectively:

- A management company under UCITS must consider sustainability risks and PAIs (if they are considered under SFDR) when ensuring a "*high level of diligence in the selection and ongoing monitoring of investments*" and when "*exercising due skill, care and diligence when entering into, managing or terminating any arrangements with third parties*".
- AIFMs must consider sustainability risks and PAIs, while applying a "*high standard of diligence in the selection and ongoing monitoring of investments*" and when they "*establish, implement and apply written policies and procedures on due diligence*".

- Lead to ambiguity, as investors complying with CSDD rules may still be subject to cases under domestic courts and the OECD National Contact Points in several jurisdictions for irresponsible practices related to human rights and environment under national and international standards. Similarly, investors complying with CSDD requirements would not necessarily meet the minimum safeguards of the EU Taxonomy regulation[5].

It has been implied that these limitations were proposed to protect SME's access to finance. However, as noted by many participants during a WBA & PRI roundtable on CSDD on 13 June 2022, this assumption is questionable. As stated in PRI's 2020 paper "*Why And How Investors Should Act On Human Rights*", investors should carry out due diligence pre- and post-investment, throughout the value chain, including on the SMEs present in their value chain. Furthermore, and in alignment within international and national standards on business and human rights, investors should actively and continuously engage with their investees to prevent and mitigate negative outcomes[6]. Many already do this (see annex) and notably, it is a comply or explain disclosure requirement for financial market participants under the shareholder rights directive[7].

Therefore, PRI recommends co-legislators amend the due diligence obligations for financial undertakings to include ongoing assessments and which cover the entire value chain. We emphasise that while that there are instances, as clarified by John Ruggie[8], the UN Working Group[9] and the OECD[10], where an investor can cause or contribute to an adverse impact, in most cases investors are instead 'linked'[11] to such adverse impacts. The responsibility related to situations of cause, contribution and linkage are set out in the UNGPs[12]. In cases where investors are linked to impacts, we strongly recommend that they should not be subject to legal liability as it is otherwise set out in the proposal.

- **Clarify the definition of 'financial services' to include equity investment**

Financial services are not defined in the CSDD proposed text. In most cases, the text refers to financial undertakings providing "*credit, loan or other financial services*". However, in Article 3(g), it states "*As regards [financial] companies […] 'value chain' with respect to the provision of these specific services shall only include the activities of the clients receiving such loan, credit, and other financial services […]. The value chain of such regulated financial undertakings does not cover SMEs receiving loan, credit, financing, insurance or reinsurance of such entities".*

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[5] Article 18 of the EU Taxonomy regulation specifies the minimum safeguards for an economic activity to qualify as environmentally sustainable include procedures implemented by the undertaking that is carrying out the economic activity to ensure the alignment with the OECD Guidelines for Multinational Enterprises and the UN Guiding Principles on Business and Human Rights.

[6] UN Office of the High Commissioner for Human Rights (OHCHR) (2011), Guiding Principles on Business and Human Rights – see Guiding Principle 17 paragraph (c) and OECD (2017), Responsible business conduct for institutional investors: Key considerations for due diligence under the OECD Guidelines for Multinational Enterprises, Table 1, pg. 31.

[7] Under Article 3g SRD II, FMPs must disclose on a comply or explain basis an engagement policy that describes how they integrate shareholder engagement in their investment strategy including how they (i) monitor investee companies on relevant matters, including non-financial performance and risk, social and environmental impact and corporate governance, (ii) conduct dialogues with investee companies, and (iii) how they "communicate with relevant stakeholders of the investee companies".

[8] John G. Ruggie (2017) Comments on Thun Group of Banks Discussion Paper on the Implications of UN Guiding Principles 13 & 17 In a Corporate and Investment Banking Context – note, although the context of this letter is the banking sector this point holds true for the whole financial industry.

[9] UN Working Group on Business and Human Rights (2021), Taking stock of investor implementation of the UN Guiding Principles on Business and Human Rights, pg. 5-8.

[10] OECD (2017), Responsible business conduct for institutional investors: Key considerations for due diligence under the OECD Guidelines for Multinational Enterprises, Box 4 pg. 15.

[11] UN Office of the High Commissioner for Human Rights (OHCHR) (2012), The Corporate Responsibility to Respect Human Rights, An Interpretive Guide pg. 16.

[12] UN Office of the High Commissioner for Human Rights (OHCHR) (2011), Guiding Principles on Business and Human Rights – see in particular Guiding Principles 13, 17, 19 and 22.

It is, therefore, unclear whether and how ‘financial services’ covers credit and provision of investment and equity. Co-legislators should clarify this and explicitly include equity investments as this would be the general expectation under international standards[13] as clarified also by the PRI. See examples of good investor due diligence practice, including listed equity, in the annex.

- **Broaden the personal scope of EU companies under the directive, in line with the CSRD**

The current limited personal scope of the Commission’s proposal is insufficient and could pose risks and challenges for investors. This is particularly the case in private markets, when it comes to managing an investor’s exposure to sustainability issues, given that a lot of these issues occur in smaller companies which are most likely to be unlisted[14]. In addition, corporate disclosure alone may not be enough to ensure the companies outside the scope of the CSDD proposal are effectively addressing negative sustainability impacts[15].

International guidelines state all companies have a responsibility to respect human rights, including by way of carrying out due diligence. Therefore, 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.

PRI recommends co-legislators to 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. Specifically, given the CSDD enters into force in 2024, Group 1 undertakings (whether EU or non-EU) should still be required to meet their due diligence obligations once transposition is complete in 2026, considering they are very large and therefore have the resources to do so. Following this, all other undertakings which are subject to CSRD reporting, should be subject to the due diligence requirements under CSDD two years later. Group 2 non-EU companies should still be required to carry out due diligence from 2028.

Timeline for *EU* companies’ obligations under CSRD and CSDD

	Group 1 EU companies	Previous NFRD companies	Other large EU companies	EU SMEs
CSRD agreement		2025	2026	2028
CSDD proposal	2026	2028 (if also >50% net turnover in high impact sectors)	2028 (if also >50% net turnover in high impact sectors)	NA
PRI recommendation for CSDD	2026	2027 (no high-impact limit)	2028 (no high-impact limit)	2030

This increase in scope would bring the CSDD into closer alignment with international guidelines and the narrative timeframe would bring clarity and certainty to other undertakings. Of course, requirements should be proportionate to the capacity of the undertaking as clarified in international

[13] In 2013, the UN Office of the High Commissioner for Human Rights (OHCHR) specifically clarified that the UNGPs apply to institutional investors - OHCHR response to Chair of the OECD Working Party on Responsible Business Conduct (2013). See also: OECD (2017), Responsible business conduct for institutional investors: Key considerations for due diligence under the OECD Guidelines for Multinational Enterprises.

[14] Please find examples of due diligence practices by private equity investors in the annex below.

[15] Evidence based on the effectiveness of the current EU corporate disclosure framework (the Non-Financial Reporting Directive): See e.g.: Villiers, C. (2019). Global Supply Chains and Sustainability: The Role of Disclosure and Due Diligence Regulation. In B. Sjåfjell & C. Bruner (Eds.), *The Cambridge Handbook of Corporate Law, Corporate Governance and Sustainability* (Cambridge Law Handbooks, pp. 551-565). Cambridge: Cambridge University Press. doi:10.1017/9781108658386.046.
See also: WBA’s 2022 Social Baseline Assessment - the average human rights score for the entire sample of EU based companies was 3.8 points out of 10, while 18% of EU companies scored zero on all human rights indicators.

standards. In addition, guidance should be provided – for example, building on the European Commission's 2012 guidance specifically for SMEs, "*My Business and Human Rights – A guide to human rights for small and medium-sized enterprises*", to cover other sustainability issues, and clarifying how different financial undertakings should interpret their responsibilities under the CSDD, in line with the UNGPs and OECD guidelines.

- **Harmonise definitions of negative impacts across CSDD, SFDR and CSRD**

The SFDR, CSRD and CSDD discuss sustainability impact due diligence[16]. A financial institution, and directly or indirectly their investees, could fall under all three pieces of legislation, so there must be coherent terminology. Specifically, there should be harmonisation between the meanings of 'principal adverse impact' under the SFDR, 'significant adverse impact' under the CSDD proposal and 'material negative impact' under the European Sustainability Reporting Standards (ESRS, which determine the detail of CSRD disclosure). Regarding the latter two, this can notably be resolved by harmonising the 'significance of impacts' in the CSDD proposal and 'scale of impacts' in the ESRS. It is of the utmost importance to harmonize definitions of negative impacts across these central sustainable finance files to avoid unnecessary confusion among users and preparers.

- **Mandate stakeholder engagement when identifying actual and potential adverse impacts**

Article 6, paragraph 4 of the CSDD proposal states *"[c]ompanies shall, where relevant, […] carry out consultations with potentially affected groups including workers and other relevant stakeholders to gather information on actual or potential adverse impacts".* The inclusion of "where relevant" contradicts UNGP 18[17], which states that this process "*should [always] involve meaningful consultation with potentially affected groups and other relevant stakeholders, as appropriate to the size of the business enterprise and the nature and context of the operation".*

PRI recommends co-legislators remove "where relevant" in this sentence and provide guidance, aligned with international standards, for how companies can ensure the dialogue is meaningful.

[16] On SFDR – see footnote 4. On CSRD - Article 1(3) of the CSRD provisional agreement (amending Article 19a(2e) of the Accounting Directive) introduces disclosure requirements regarding an undertaking's due diligence process with regards to sustainability matters and principal actual or adverse impacts. The detail for these disclosures will be specified in the European Sustainability Reporting Standards (ESRS) – see paragraph 86 of section 2.5. of Draft ESRS 1 General Principles.
[17] UN Office of the High Commissioner for Human Rights (OHCHR) (2011), Guiding Principles on Business and Human Rights – see Guiding Principle 18, pg. 19.

EXECUTIVE REMUNERATION RECOMMENDATIONS

We welcome the consideration of directors' remuneration in Article 15(3) of the CSDD proposal. However, by focussing only on climate change mitigation objectives, and only for 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 in changing director's practice to actively consider sustainability factors, will be severely diminished.

- **Broaden the range of sustainability factors that should be considered when setting variable remuneration**

Focussing on climate change disregards the importance of other sustainability factors and the interconnectedness between E, S and G issues. It could also lead to incoherencies with reporting under the CSRD since, under EFRAG's Draft ESRS 2: General, strategy, governance and materiality assessment, remuneration-related reporting requirements on targets would apply to all ESG issues.

Co-legislators should give boards 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. For example, fossil fuel intensive industries may choose to focus on climate change while the health sector may look at social impacts.

Where companies face challenges in identifying the right metrics or targets for certain ESG issues, they should be encouraged to disclose these issues, in addition to describing the process undertaken, so investors and stakeholders can understand the rationale and meaningfully input into the process. In addition, the remuneration committee should be able to use their discretion and tools such as clawback provisions to adjust remuneration following unusual events.

- **Strengthen the link between variable remuneration and sustainability performance**

If structured appropriately and implemented effectively, ESG-linked pay can rebalance the excessive emphasis on short-term performance targets in typical remuneration packages, which may run contrary to long-term financial and sustainability objectives[18]. Therefore, co-legislators should ensure the CSDD proposal clearly mandates the incorporation of sustainability factors into director's remuneration by removing the conditionality of Article 15(3) i.e., that this requirement is only for 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 incorporation of ESG metrics into both long-term and short-term remuneration packages can be an important tool to drive value and better sustainability performance.

In making this amendment, co-legislators should be aware that the PRI has not identified evidence that mandating a *specific proportion* of ESG-linked pay addresses the sustainability issues constructively[19]. In fact, it could be sub-optimal and result in unintended consequences such as companies over-weighting ESG factors that may be easier to quantify, or adopting operational targets that would be easily met through the course of the business (e.g. in relation to compliance). Any requirements on executive remuneration should be accompanied by guidance from the Commission to prevent 'pay padding', backward looking performance targets and other potential unintended consequences.

[18] ESG-linked pay: Recommendations for investors | Article | PRI (unpri.org).
[19] ESG-linked pay: What does the research say? | Article | PRI (unpri.org).

- **Take the wider workforce into account when setting variable remuneration**

The COVID-19 pandemic has highlighted the need for companies to reign in excessive bonuses and stock grants to prevent stark divergences in the incomes for workers and executives. Under the Shareholder Rights Directive II (SRD II), companies are already required to explain in their remuneration policy how pay and employment conditions of employees were considered when establishing directors' remuneration policy. As a next step, companies should demonstrate tangibly how these considerations have been taken into account by identifying pertinent metrics to link to executive pay packages.

Co-legislators should mandate that remuneration committees give due consideration to the conditions and pay of the wider workforce when setting director remuneration to ensure proportionate pay policies and structures are in place. Companies should proactively take steps to adjust executive rewards and ensure alignment with the broader workforce remuneration. For instance, pay ratio could be used as one input to decision making around remuneration. This can prompt dialogue where a year-on-year increase in the ratio is not justified by different calculation methodologies or changes in business operations.

TRANSITION PLAN RECOMMENDATIONS

- **Strengthen requirements on transition plans and increase alignment with CSRD**

Under Article 15 of the CSDD proposal, very large companies must "*adopt a plan to ensure that the business model and strategy of the company are compatible with the transition to a sustainable economy and with the limiting of global warming to 1.5 °C in line with the Paris Agreement."* This duplicates the language of the provisional CSRD agreement, but adds "*This plan shall, in particular, identify, on the basis of information reasonably available to the company, the extent to which climate change is a risk for, or an impact of, the company's operations."* Furthermore, *"in case climate change is or should have been identified as a principal risk for, or a principal impact of, the company's operations, the company [must include] emission reduction objectives in its plan*".

However, Article 15 does not provide a description on how to adopt such a plan. In contrast, under Draft ESRS 1: Climate change paragraph 15, companies that have committed to 1.5°C alignment would need to explain the following regarding their transition plans:

- How the business model/strategy, GHG emissions reduction targets and future business growth (in terms of locked-in emissions by 2030 and 2050) are compatible with this commitment;
- How Taxonomy alignment supports their transition;
- How the transition plan is embedded in and aligned with the overall business strategy and financial planning, whether it has been approved by governance bodies, and progress made in implementing the transition plan; and
- Decarbonisation levers, key actions, resources (where relevant), and progress.

The CSDD should clarify how a company should identify the extent to which climate change is a risk for, or an impact of, its operations. Undertakings where "*climate change is or should have been identified as a principal risk for, or a principal impact of, [their] operations"* (as stated in Article 15(2) of the CSDD) should be required to meet specific actions and resource allocations that will allow them to achieve their emission reduction objectives. This would help investors to verify the feasibility/likelihood of anticipated future resilience and sustainability performance improvements, better engage

companies and track progress. Both recommendations should be completely aligned with, and match the granularity of, the transition plan disclosures under the ESRS (once finalised).

- **Clarify how companies can support the just transition**

PRI also recommends co-legislators clarify how companies can support the transition to a "sustainable economy" as a whole, in line with the concept of a just transition[20]. The transition to net zero will affect many aspects of the economy and society, and the PRI supports the development and implementation of transition plans that are not only consistent with the Paris Agreement, but also deliver impact on the real economy and align with the UN Sustainable Development Goals.

- **Define key terms in transition plan requirements**

Finally, co-legislators should define what is meant by a 'principal' risk or impact to ensure the requirement to include emission reduction targets is applied consistently across entities, sectors and jurisdictions. In addition, co-legislators should amend paragraphs 1 and 2 of Article 15 to cover companies "operations *and activities*" to explicitly include scope 3 emissions from upstream and downstream activities[21].

OTHER KEY PRELIMINARY CONSIDERATIONS

In the below text the PRI wishes to highlight other key preliminary considerations for the proposed CSDD. We understand the complexity of this file and need for clear obligations for companies. These key preliminary considerations remain to be further explored in order to make precise recommendations. We encourage co-legislators to reflect on the input from experts in these areas.

- **'Established business relationships' and 'contractual cascading'**

In the CSDD proposal, the due diligence obligation is limited to a company's own operations, those of its subsidiaries and 'established business relationships' defined in Article 3(f) 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".* This definition deviates from the UNGPs by focusing on factors that may not be relevant to the severity of the risks involved and limiting the scope of companies to be assessed.

Furthermore, in Article 7(2) point (b) and Article 8(3), point (c), the Commission has introduced 'contractual cascading' to require a company, where relevant, to seek contractual assurances that their business partner will prevent and/or bring to an end negative sustainability impacts. Under Article 22(2), a company which has done this will "*not be liable for damages caused by an adverse impact arising as a result of the activities of an indirect partner with whom it has an established business relationship, unless it was unreasonable, in the circumstances of the case, to expect that the action actually taken, including as regards verifying compliance, would be adequate to prevent, mitigate, bring to an end or minimise the extent of the adverse impact*". This also deviates from international standards by assuming that putting a contract in place may be sufficient to demonstrate adequate due diligence. It is unclear how the use of contractual clauses would effectively allow for prevention and remediation of adverse impacts throughout value chains.

[20] For information on how investors can pursue the goal of a just transition as part of their core operating practices, see Grantham Research Institute on Climate Change and the Environment (2018) Climate change and the just transition, A guide for investor action

[21] TCFD (2017) Final report: Recommendations of the Task Force on Climate-related Financial Disclosures – see definition of value chain on pg. 64.

The PRI is aware that the Commission's has tried to implement clear liability rules for companies and therefore introduced these terms to ensure companies had clarity on their obligations. However, we would strongly caution against the use of the following concepts:

- 'established business relationships', since this will lead to companies either missing or ignoring impacts further down the value chain (where they can be most severe) and/or possibly 'gaming' the system to avoiding entering into scope e.g. by prioritizing short-term business relationships; and the use of
- 'contractual cascading', since this will lead to misunderstanding (e.g. it is the risk to people/environment not the risk to business that is important when assessing the adequacy of due diligence) and companies seeing compliance as a "tick-box approach".

We strongly encourage co-legislators to consider how these risks could be avoided and to ensure that obligations are accompanied by clear and precise guidance on how to identify the salient issues to tackle, in line with the UNGPs and OECD guidelines i.e., focus on scope, scale and irremediability and the use of leverage and multi-stakeholder avenues to find solutions. While further work and analysis needs to be done, we recommend co-legislators take note of the European Economic and Social Committee's opinion and consider how the use of the concepts "cause", "contribute" and "directly linked" under the UNGPs[22] and OECD guidelines[23] could be used to clarify the liability regime.

- **Directors' duties**

Currently, there is no explicit duty in EU law for directors to generally act in accordance with the company's long-term interests, shareholders' views or to incorporate stakeholder interests. As such, the interpretation and precise formulation of directors' duties, and the processes they must take into consideration, varies across Member States. Therefore, the CSDD presents a significant opportunity for harmonised and strong duties throughout the EU.

However, compared to the Commission's initial impact assessment, the coverage of director's duties in this proposal is extremely limited. 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 does not provide sufficiently clear direction to lead to strong, harmonised duties throughout the EU.

Directors should have a duty to consider the interests and needs of shareholders and stakeholders and the social and environmental impact of company operations to allow a more holistic approach for the maximisation of social, environmental, as well as economic/financial performance. We recommend co-legislators clarify how to balance and prioritise these interests over different time horizons by providing accompanying guidance to the proposal. Stakeholder's (including employee's) and shareholder's interests must be respected; the accountability of management from corporates to their investors should not be reduced or eliminated.

In the longer-term, we recommend the Commission to undertake a rigorous legal and impact analysis to understand how to achieve the desired shift in focus towards long-term sustainability. This could inform a review of Articles 25 and 26 to strengthen and clarify the duties while supporting existing corporate governance regimes that consider stakeholder interests to a varying extent across Member States.

[22] UN Office of the High Commissioner for Human Rights (OHCHR) (2011), Guiding Principles on Business and Human Rights – see Guiding Principle 13.
[23] OECD (2011) OECD Guidelines for Multinational Enterprises – see section IV Human Rights, paragraphs 1-6 on pg. 31.

ANNEX: GOOD INVESTOR DUE DILIGENCE PRACTICE

Below are seven illustrative examples by European investors of due diligence practices across different asset classes and portfolios and including both pre and post-investment (i.e., stewardship/engagement) which have been shared with the PRI as part of our case studies programme.

ABN AMRO (link to case study)

Signatory type: Investment manager	**HQ country**: Netherlands	**Asset class**: Agnostic

Practice: ABN AMRO developed a Human Rights Risk Register in 2020 to identify, manage and address the bank's human rights risks. The identified risks are monitored and managed on an ongoing basis.

- To do this, four salient issues related to ABN AMRO's investment services operations were identified: (1) labour rights; (2) land-related rights; (3) right to life / right to health; and (4) right to privacy / freedom of expression.
- The Risk Register describes these four issues in detail and links them to sectors in which their investment services clients can invest.

Abris Capital Partners (link to case study)

Signatory type: Investment manager	**HQ country**: Poland	**Asset class**: Private Equity

Practice: Human rights considerations are incorporated throughout Abris Capital Partners' investment process, with heavy emphasis on the value chain impacts Components at each stage include (amongst other things):

- Pre-acquisition due diligence – analyse human rights risks in four main areas (working and employment conditions; use of employment agencies that recruit temporary workers; the supply chain; and the use of new technologies).
- Post-investment assessment and guidance – continue to assess portfolio companies on their human rights risk level (risk exposure; management practices; and compliance standards).
- Post-investment annual analysis of human rights risks using Abris' ESG Scoring Application – use a tool developed for ESG risk management.
- Post-investment engagement with portfolio companies – require each portfolio company to include a human rights clause in contracts with business partners.

AkademikerPension (link to case study)

Signatory type: Asset owner (pension fund)	**HQ country**: Denmark	**Asset class**: Fixed Income

Practice: AkademikerPension incorporates human rights into its sovereign bond investments on an ongoing basis. This is done through:

- Conducting quarterly screenings of sovereign states' sustainability profiles. These assessments cover the country's management of E, S and G issues. The social pillar encompasses a wide range of human rights-related issues, including formal and actual protection of labour rights, civil/political rights and social/economic rights. If countries do not meet a minimum threshold, they are placed on an internal focus list for further analysis.
- Assessing and monitoring the severity of the situation as well as the potential for positive development.

AP2 (link to case study)

Signatory type: Asset owner	**HQ country**: Sweden	**Asset class**: Listed equity, fixed income

Practice: AP2 assesses the human rights outcomes of its internally managed, quantitative, global listed equities portfolio on an ongoing basis to identify which of its companies to engage with further. This is done through:

- Identification of common risks for negative human rights outcomes in sectors in which AP2's portfolio companies operate.
- Focus on portfolio companies' regions of operations and associated human rights risks, with an emphasis on value chain impacts.
- Investigation into policies and processes in place to manage these risks.
- Assessment on the severity of human rights outcomes – scale, scope and irremediability.

Ohman Fonder and Folksam (link to case study)

Ohman Fonder	**Signatory type**: Investment manager	**HQ country**: Sweden	**Asset class**: Listed Equity
Folksam	**Signatory type**: Asset Owner	**HQ country**: Sweden	**Asset owner type**: Insurer

Practice: Ohman and Folksam engage with companies on human rights by doing the following:

- Conducting thorough ESG due diligence of all companies they invest in to ensure they are aware of any potential social risk that is not properly addressed.
- Monitoring ESG-related news of portfolio companies to capture severe social incidents on an ongoing basis. E.g. Ohman and Folksam co-filed a shareholder proposal for Amazon on human rights in 2020, which led to the launch of a Global Human Rights Principles. Their human rights-focused engagement objectives for Amazon are three-fold:
    1. Encourage Amazon to develop a human rights policy.
    2. Encourage Amazon to publish a process for how the human rights policy should be implemented across the organisation and its entire value chain.
    3. Ensure Amazon complies with the policy, without any major incidents.

PAI Partners (link to case study)

Signatory type: Investment manager	**HQ country**: France	**Asset class**: Private equity

Practice: PAI Partners has processes in place to manage supply chains and their inherent risks including (amongst others):

- Risk analysis of the targeted or recently acquired company, considering the centrality (i.e. severity, how it may impact business) and proximity of the business (brands at risk when an ethical issue occurs) and based on the integration of international standards with a focus on four pillars (social, environment, governance, and external stakeholders).
- Engagement with portfolio companies through regular meetings and using "due diligence questions on supply chain" on an ongoing basis, which require the companies to share supply chain sustainability tools and processes put in place to collect exact origins, locations and names of tier 1 and 2 facilities and suppliers; sustainability factors considered in the selection of suppliers; and commitment to ESG standards (BSCI, Sedex, ICS, WRAP).

Polaris (link to case study)

Signatory type: Investment manager	**HQ country**: Denmark	**Asset class**: Private equity

Practice: Polaris applies "responsible investment" in the investment phase (bullet points 1 and 2) and ownership period (bullet points 3-5):

1. Asses all new acquisitions against the UNGPs and OECD Guidelines (see link for criteria used).
2. Incorporate corporate social responsibility (CSR) due diligence in investment risk assessment and decision making.
3. Secure compliance with UNGP/OECD.
4. Provide tools, guidance, and knowledge sharing opportunities on CSR with portfolio companies, such as the Polaris Excellence Model.
5. Include CSR performance as part of performance review and conduct an annual CSR impact assessment.