

# THE ROLE OF FINANCIAL INSTITUTIONS IN THE CORPORATE SUSTAINABILITY DUE DILIGENCE DIRECTIVE (CSDDD)

Financial institutions promote economic growth by channelling capital and driving investment. They also play a critical role in diversifying and mitigating risk. All actors within the financial sector are therefore crucial to shaping sustainable economic systems, exerting leverage over a broad range of other industries and business activities, as well as in upholding the protection of human rights and the environment globally.

## Filling the gaps of current sustainable finance rules

The EU's Action Plan on Financing Sustainable Growth<sup>1</sup> called for the mainstreaming of sustainability issues (also referred to as Environmental, Social and Governance (ESG) issues) in financial risk management. Concretely, the subsequent legislative proposals from this plan focus on investor disclosure<sup>2</sup> and designing metrics to assess sustainable economic activity.<sup>3</sup>

However, these combined approaches largely focus on disclosure and voluntary adherence, which will not lead to the transformational behavioural changes needed for the financial sector to address sustainability challenges. The Corporate Sustainability Due Diligence Directive (CSDDD)<sup>4</sup> provides an unprecedented opportunity to fill this regulatory gap and to ensure that financial institutions adequately incorporate sustainability risks across their entire value chain.

By providing financing and liquidity to businesses, the financial sector plays a decisive role in the economy. Our proposals aim to ensure that the financial sector will also be able to support strong human rights and environmental protection. It is a unique opportunity for the financial sector to take concrete steps towards fostering sustainable investment and responsible financial practices.

## Addressing the shortcomings of CSDDD

While the European Commission has acknowledged the role of the financial sector in its CSDDD proposal,<sup>5</sup> it has significantly limited the scope of financial institutions' inclusion and exempted the sector from key obligations. It therefore does not require them to conduct meaningful human rights and environmental due diligence.

These limitations and exemptions risk enabling negative human rights and environmental impacts funded and/or facilitated by financial institutions, and increasing compliance risks for other economic actors across value chains. They also clearly contradict recognised international frameworks such as the OECD Guidelines and the UN Guiding Principles on Business and Human Rights.<sup>6</sup> The frameworks and the accompanying guidance set clear expectations for sustainable investment and finance facilitation. New EU regulations must not lower the bar.

**We call on EU co-legislators to address these shortcomings and amend CSDDD to ensure that meaningful due diligence obligations for financial institutions are in line with international frameworks.** Doing so will contribute to the level-playing field that a broad range of financial actors have demanded, facilitating consistency and compliance across markets and jurisdictions.

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## What is missing in the proposal?

- **Financial institutions are only obliged to conduct due diligence once, prior to providing their services** (Article 6(3)). This runs contrary to the principle of human rights due diligence outlined in international frameworks, namely that the due diligence process is not static, but ongoing, responsive, and changing.<sup>7</sup> Companies should conduct due diligence throughout the entire relationship and on an ongoing basis, not only during the pre-contractual phase, as highlighted by investor groups.<sup>8</sup>
  - We call on EU co-legislators to remove this exemption and align the ongoing due diligence obligations for financial institutions with other companies included in this directive's scope, requiring them to identify and assess adverse impacts throughout the entire business relationship lifecycle, including periodically when reviewing clients and credit processes.
- **The definition of “value chain” limits the responsibilities of financial institutions only to direct large clients** (Article 3(g)). This limitation to the first relationship excludes entities in these clients' own value chains as well as direct clients that are SMEs.
  - We call on EU co-legislators to require that financial institutions identify risks throughout their entire value chains and investment portfolios, in line with international frameworks on the due diligence obligations for companies.
- **Financial institutions are not required to terminate their relationship with a company where this termination could cause ‘substantial prejudice’ to that company** (Art 7(6) & Art 8(7)). Financial institutions must use their leverage to mitigate adverse impacts in their investment chains, with the understanding that divestment should be considered when other measures have failed. The legislation should not preclude financial institutions from terminating the provision of financial services to harmful entities.
  - We call on the EU co-legislators to remove blanket exemptions to potential divesting and instead recognize the importance of engagement and exerting leverage when conducting due diligence. The directive should clarify that financial institutions can terminate the provision of financial services to harmful entities where adequate alternatives have been exhausted, in line with responsible disengagement requirements and international best practices.<sup>9</sup>
- **The financial sector is not included in the Commission's list of high-impact sectors** (Art 2(b)), even though the Commission's own assessment of high-impact sectors is otherwise based on sectoral OECD due diligence guidance, which captures the financial sector.<sup>10</sup>
  - We call on EU co-legislators to reflect the financial sector's outsized impact on human and environmental rights and the OECD's specific guidance for institutional investors and banks, and to therefore consider the financial sector as a high-impact sector.

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## Why should we close this regulatory gap for financial institutions?

### Harmful Human Rights and Environmental Impacts

Financial institutions, including banks, asset managers, pension funds, investors, hedge funds, insurers, and trading venues, must be able to identify whether their assets, the companies they support, or the services they provide will negatively impact people or the planet, and then take measures to prevent and mitigate that impact. EU-based financiers and their subsidiaries have played central roles in financing projects that have caused human rights violations and environmental damage, and have been linked to land grabbing, deforestation, and violence against communities and land and environmental defenders.<sup>11</sup> Given this role in global value chains, financial institutions should be held to the same standards as companies across other sectors.

### Alignment with international guidelines

The proposed financial sector exemptions go against the OECD's specific guidance for financial institutions.<sup>12</sup> The UN Guiding Principles and OECD Guidelines equally apply to financial institutions and actors, such as commercial banks, retail banks, investment banks, rating agencies, financial service providers and institutional investors. In fact, National Contact Points have accepted several OECD cases related to financial institutions' role in human rights abuses and environmental harm of their investee companies, showcasing an already established expectation for financial institutions to address harm in their investment chain.<sup>13</sup>

## SUPPORTING ORGANIZATIONS

The logo for BANKTRACK, with "BANK" in red and "TRACK" in blue, and a red dot in the "O" of "TRACK".The logo for Brot für die Welt, with "Brot" in orange and "für die Welt" in black.The logo for International Service for Human Rights, featuring a red stylized human figure icon and the text "International Service for Human Rights" in blue and red.The logo for FairFinance International, with a colorful wave graphic and the text "FairFinance International" in white.The logo for Frank Bold, with a red stylized "S" icon and the text "Frank Bold" in red.The logo for global witness, with the text "global witness" in black and a red circular icon containing a white stylized figure.The logo for ShareAction, with the text "ShareAction" in grey and two green arrows pointing right.The logo for süd, with a red stylized "S" icon and the text "süd" in blue, and "INSTITUT FÜR ÖKONOMIE UND ÖKUMENE" in small black text below.The logo for World Benchmarking Alliance, with a colorful circular icon and the text "World Benchmarking Alliance" in black.The logo for WWF, featuring a black and white panda silhouette and the text "WWF" in black.

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- 1 European Commission, “Overview of Sustainable Finance”, <[https://finance.ec.europa.eu/sustainable-finance/overview-sustainable-finance\\_en](https://finance.ec.europa.eu/sustainable-finance/overview-sustainable-finance_en)>
- 2 Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector, <<https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32019R2088>>
- 3 Regulation (EU) 2020/852 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088, <<https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex:32020R0852>>
- 4 Proposal for a Directive on Corporate Sustainability Due Diligence and Annex, <[https://ec.europa.eu/info/publications/proposal-directive-corporate-sustainable-due-diligence-and-annex\\_en](https://ec.europa.eu/info/publications/proposal-directive-corporate-sustainable-due-diligence-and-annex_en)>
- 5 Proposal for a Directive on Corporate Sustainability Due Diligence and Annex
- 6 OECD Guidelines for Multinational Enterprises, “Operationalizing RBC Due Diligence Amongst Financial Sector Practitioners”, <<https://mneguidelines.oecd.org/rbc-financial-sector.htm>>  
; OHCHR Business and Human Rights – Financial Sector, <<https://www.ohchr.org/en/business-and-human-rights/financial-sector>>
- 7 OECD Due Diligence Guidance for Responsible Business Conduct, 17, <<http://mneguidelines.oecd.org/OECD-Due-Diligence-Guidance-for-Responsible-Business-Conduct.pdf>>
- 8 In their position paper, Principles for Responsible Investment (PRI) ask to “*Remove the pre-service limitation to investor due diligence to include ongoing assessments, throughout the value chain, in line with international standards*” <<https://www.unpri.org/download?ac=15613>>
- 9 International Service for Human Rights (ISHR): “Safeguarding Human Rights Defenders: Practical Guidance for Investors”, <<https://ishr.ch/wp-content/uploads/2020/04/safeguarding-human-rights-defenders-practical-guidance-for-investors-final-4-28-20-1.pdf>>
- 10 Proposal for a Directive on Corporate Sustainability Due Diligence, Recital 22.
- 11 Global Witness, “Indecent Exposure,” <<https://www.globalwitness.org/en/campaigns/land-deals/indecent-exposure/>>
- 12 OECD Guidelines for Multinational Enterprises, “Operationalizing RBC Due Diligence Amongst Financial Sector Practitioners”, <<https://mneguidelines.oecd.org/rbc-financial-sector.htm>>
- 13 The OECD Guidelines require each country adhering to the OECD to establish a National Contact Point (NCP) to promote the Guidelines and resolve claims of corporate misconduct, <<https://www.oecdwatch.org/>>; numerous OECD cases related to financial institutions’ responsibility for harms in their investment chain are being accepted, e.g. *Milieudefensie et al vs. ING*, *EC and IDI vs. Australia and New Zealand Banking Group*.