Position Paper

FERMA position paper on the European Commission's proposal for a Corporate Sustainability Due Diligence Directive (CSDD)

23 May 2022

Summary:

- FERMA welcomes the ambitions in the proposal for a corporate sustainability due diligence directive (CSDD).
- The CSDD represents another important step forward to the adoption of a robust **Enterprise Risk Management** (ERM) approach, which will be key to complying with the CSDD requirements.
- However, we have two main concerns, which relate to:
  - The notion of **value chain** and its impact on how organisations **practically implement the due diligence process;** and,
  - The uncertain implications of the proposed measures on **civil liability.**
- FERMA therefore recommends the following:
  - FERMA suggests the focus of the due diligence process obligations should be on direct suppliers (tier I) through a **cascade process**: each company would oblige (by contractual agreement, for example) their direct suppliers (tier I) to apply the same due diligence process on the suppliers of their suppliers (tier II), and so on.
  - FERMA calls on the European Commission to elaborate a minimum harmonized framework for **civil liability** as it concerns the CSDD at EU-level (in order to minimise gaps across EU Member States).
  - FERMA seeks clarity from the European Commission on the notion of **damages** in CSDD.

Introductory remarks

FERMA is a great supporter of the European Commission's ambitions to succeed in the transition to a climate-neutral and green economy and in delivering on the UN Sustainable Development Goals. We recognise the clear ambition to urge companies to better integrate sustainability into their corporate governance. From our perspective, it is overall positive to observe that the CSDD proposal borrows so much from a risk management approach.

We are an active voice at EU-level promoting the crucial and strategic role that risk management plays for organisations on their sustainability journey. For instance, we have authored a sustainability guide for risk managers, and we have contributed our views in the processes for corporate sustainability reporting and sustainable corporate governance, to name a few. Also, in the context of risk transfer, we are a firm believer in captives as a supportive risk management tool and an enabler for more sustainable organisations and a more resilient EU economy.

A corporate culture that embraces Enterprise Risk Management (ERM[1]) is a fundamental factor in determining how organisations approach and deal with sustainability. Managing sustainability requires mature risk management as a long-term project to build resilience. Bearing all of this in mind, FERMA

[1] Enterprise risk management (ERM) is an enterprise-wide strategy to identify and prepare for risks to an organisation's finances, operations, and objectives.

is keen to contribute as the voice of the European risk management community to the reflections on CSDD.

FERMA's main points of concern with the CSDD proposal

As the representative voice of professional risk managers, FERMA has identified **two main challenges** for companies in meeting the objectives set out in the CSDD proposal:

- There would be practical difficulties in implementing the **due diligence process in the value chain**; and,
- There are uncertain implications related to the **civil liability** dimension of the proposal.

Furthermore and overall, it is likely that the CSDD will increase costs for companies, consumers, and society (i.e. stakeholders). This is especially so if the period for companies to adapt to the range of changes introduced by the CSDD is short. FERMA therefore asks the European Commission to leave sufficient time for companies to ensure they have the appropriate systems and processes (e.g. ERM) in place to comply with CSDD's requirements.

Value chain, the due diligence process and practical implementation: a trilemma

FERMA recognises the European Commission's ambition in articulating a concept of "value chain" and welcomes the European Commission's proposed due diligence process –Articles 5 to 11– which is in line with a classical risk management approach, i.e. identifying, assessing, and treating risks.

However, we foresee a trilemma:

- **First, there are likely to be high business consequences in implementing the due diligence process to the letter**:
    - How are companies with for example tier II suppliers working in countries with weak records on human rights (such as China) expected to mitigate or bring to an end the full range of potential and actual adverse impacts?
    - How is it possible for businesses to deal with a monopoly supplier of a specific commodity or good being located in a country with environmental standards not in line with those in the EU?
    - How to ensure that requirements do not put at risk the security of supply of urgently needed goods?
- **Second, there is an information problem in terms of availability, access and processing**. Based on the experience of some FERMA members with existing legislation in this field (e.g. *loi relative au devoir de vigilance* in France, and the *Lieferkettengesetz* in Germany), we can say that the ability of EU enterprises to access the appropriate information about suppliers, as well as identify the appropriate sources of information could be challenging. Further, taking into account and analysing the entire value chain in many cases would go beyond the contractual relationships and would require extraordinary additional resources. This could especially be the case where suppliers are located outside of the EU.
- **Third, there is an evidence problem.** In the instances where an adverse impact cannot be brought to an end, there will be challenges for companies to demonstrate best-efforts have been made, or even more concretely, the appropriate actions have been taken. As such, how are companies expected to make this auditable and therefore audited? And what is actually going to be audited?

Furthermore, as risk managers we take an enterprise-wide view and foresee problems emerging between an *exhaustive* approach – as implied by practically implementing value chains as defined in recital 18, and definition in Art. 3 (g) – and the more practical need for prioritisation.

Enterprise-risk management aligns risk identification and prioritisation with the strategic goals and risk appetite of organisations. The key word here is **prioritisation**. Companies cannot tackle every potential risk, nor service provider, but they can tackle those which they set as priorities. Taking an exhaustive approach is often lengthy, costly and may not fully serve the purpose of the legislation.

Recommendation:

- FERMA suggests that the focus of the due diligence process obligations should be on direct suppliers (tier I) through a **cascade process**: each company would oblige (by contractual agreement, for example) their direct suppliers (tier I) to apply the same due diligence process on the suppliers of their suppliers (tier II), and so on.

Civil liability and CSDD: the need to avoid liability "à la carte"

FERMA recognises the need to enforce sustainability standards across enterprises operating in the EU. Bearing this in mind, FERMA has identified the following challenges where civil liability and the proposal on CSDD come together:

- First, FERMA understands that the civil liability regimes will eventually be framed by Member States. We are therefore concerned that gaps may arise across countries, or even be reinforced. This possible patchwork of regimes can contribute to an already challenging compliance map for multinational companies operating in different EU Member States. Furthermore, it could lead to an unlevel playing field.
- Second, FERMA regrets there is no clear definition of damages in the CSDD proposal, which is a central notion regarding liability. This creates an uncertainty that has (*un*)clear implications on the scope and perimeter of liability for companies. Furthermore, this is a very challenging area for enterprises right now in the realm of risk transfer: there is less and less coverage available, and further uncertainty in this area could potentially leave many companies more exposed to financial difficulties from lack of coverage.

Recommendations:

- FERMA calls on the European Commission to elaborate a minimum harmonized framework for liability at EU-level as it concerns the CSDD (in order to minimise gaps across EU Member States).
- FERMA seeks clarity from the European Commission on the notion of damages in CSDD.

About FERMA

The Federation of European Risk Management Associations brings together 22 national risk management associations in 21 European countries. FERMA represents the interests of nearly 5000 risk and insurance managers in Europe active in a wide range of business sectors from major industrial and commercial companies to financial institutions and local government bodies. More information can be found at www.ferma.eu

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