

SSMA Comments on the Company Sustainability Due Diligence Directive (CSDD)

6th May 2022

1. Introduction

The Swedish Securities Markets Association (SSMA) is an industry association founded in 1908 and representing the interests of 24 banks, investment banks and investment firms active in Swedish securities markets.¹

The SSMA supports the aim to advance work in the field of human rights and sustainability, a field where there are presently several ongoing regulatory initiatives and actions with an impact on SSMA members and their clients including the CSRD, SFDR, and the Taxonomy, as well as relating to specific areas such as trafficking and batteries. In addition, there are several established and successful self-regulatory initiatives in this field by organisations including the OECD and the UN.

The SSMA has reviewed the Commission proposal of 23 February 2022 for a directive on Company Sustainability Due Diligence (CSDD) together with members of its Sustainability Working Group and has based on such review the following comments which are now submitted as a response to the Commission *Have your say* consultation.

2. Better regulation – CSDD published despite two negative opinions by the Commission’s Regulatory Scrutiny Board

Before commenting on the details of the CSDD, the SSMA would like to provide some general comments on the Commission’s handling of this initiative, in light of the *Commission Better Regulation Agenda*.

The SSMA fully supports the Commission’s Better Regulation Agenda which has been in place since 2015. The objective of the Better Regulation Agenda is to make sure that EU actions are based on evidence, that they make simpler and better EU laws, and that they involve citizens, businesses, and stakeholders in the decision-making process. An important role is in this process played by the Regulatory Scrutiny Board (RSB), an independent body within the Commission that advises the College of Commissioners.

While the ultimate decision on the publication of a legislative proposal does not rest with the RSB, the SSMA notes that the RSB did not once but twice issue opinions marked “NEGATIVE” on the CSDD proposal. The RSB noted the following in its 2nd negative opinion²:

¹ For further information about the SSMA please refer to: www.svenskvardepappersmarknad.se

² Regulatory Scrutiny Board Opinion SEC (2022) 95 dated 26.11.2021

“(B) Summary of findings ... the Board maintains its negative opinion, because the revised report still contains the following significant shortcomings:

- (1) The problem description remains vague and does not demonstrate the scale and likely evolution of the problems the initiative aims to tackle. It does not provide convincing evidence that EU businesses, in particular SMEs, do not already sufficiently reflect sustainability aspects or do not have sufficient incentives to do so.
- (2) The presented policy options remain too limited in scope. Key policy choices are not identified nor fully assessed.
- (3) The impacts are not assessed in a sufficiently complete, balanced and neutral way. Uncertainty related to the realisation of benefits is not sufficiently reflected.
- (4) The report does not sufficiently demonstrate the proportionality of the preferred option.”

The Commission in its Follow-up to the 2nd opinion³ provide some additional information in response to issues raised by the RSB. This additional information has however not been provided to the RSB, nor is any further action to be expected from the RSB.

Against this background, the SSMA has major concerns with the fact that the CSDD has been published by the Commission without a positive opinion or “green light” from the RSB. It is on the contrary published despite the proposal receiving two opinions market “NEGATIVE” from the RSB.

3. Harmonisation vs fragmentation

An objective of the CSDD is to harmonise and avoid fragmentation of company sustainability due diligence standards in the EU. In the background to the CSDD it is noted that at present France and Germany have introduced legislation in this field, and that there are plans to do this also in Belgium, the Netherlands, Luxembourg, and Sweden. It is further noted that many companies, albeit not all, support and apply the self-regulatory initiatives already in place.

Against this background, the SSMA would have considered it reasonable that an EU initiative in this field would already from the outset be aligned with prevailing practices. Instead, the published CSDD proposal goes much further than existing practices, not least by introducing a civil liability regime. As the CSDD is a directive, this will in practice leave it up to the 27 EU Member States to implement, interpret, enforce and sanction at national the CSDD including the civil liability regime.

The above means that supervisory authorities in and outside of financial services as well as national courts in Member States will be tasked with applying and interpreting, in accordance with their own legal traditions and procedures, terms such as “reasons to believe”, “reasonable grounds” and legitimate concerns” set out in the CSDD. They will also have to apply those terms in relation to

³ SWD (2022) 39 final dated 23.2.2022

international conventions and agreements in relation to *inter alia* the Universal Declaration of Human Rights and the Paris Agreement.

Against this background, the SSMA is concerned that the end result of the CSDD will not be harmonisation but rather more fragmentation, as supervisory authorities and national courts in 27 EU Member States will be tasked with implementing, interpreting, enforcing and sanction CSDD including the newly introduced civil liability regime, relating to *inter alia* the Universal Declaration of Human Rights and the Paris Agreement.

4. Alignment with other existing initiatives

As noted in the impact assessment and recitals of the CSDD, several initiatives of a regulatory and self-regulatory nature are in place or in the making in the field of human rights and sustainability including sustainable finance. However, most of the relevant initiatives in the field of sustainable finance are not yet finalized or implemented, meaning that details are in many cases not in place. This relates not least to initiatives relevant in this context such as the CSRD and the Social Taxonomy.

Against this background, the SSMA stress the importance of alignment, when it comes to substance as well as timing, between the CSDD and other related regulatory as well as self-regulatory initiatives.

5. Supervisory authorities and sanctions

CSDD will apply to a significant number of companies active in different business sectors, and art 17 as a result provides that Member States may designate one or more national supervisory authorities to ensure compliance with the rules. The Commission is expected to establish a European Network of Supervisory Authorities, to coordinate and align regulatory, investigative, sanctioning, and supervisory practices, and to share information among supervisory authorities.

The SSMA considers that the proposed rules raise many important questions relating *inter alia* to what rules will apply to the proposed collaboration including on exchange of information between the CSDD supervisory authorities, considering that this group will likely include financial supervisors as well as authorities active in other areas.

In connection therewith, the SSMA notes that sanctioning rules shall be established by Member States and be based on the turnover of the company, without providing further details in this very important area.

As an example, it should be clarified what responsibility a parent company of a consolidated group has in relation to the CSDD. If a subsidiary is in breach a provision of the CSDD, will the turnover of the subsidiary, the parent company or the group be used when calculating the fine? To always use the turnover of the parent company or group creates an unproportionate burden for parent companies, especially in large groups.

The directive does not define at EU-level the limits related to the companies' turnover in relation to pecuniary sanctions in Article 20 (3). This means that there is a risk that different limits are set in different Member States, which would go against the purpose of this directive as it would not create

harmonization within the EU. As the CSDD provides both for sanctions and civil liability, it needs to be ensured that a company is not penalized twice for the same action.

SSMA notes that the intention of the Commission is not that companies should abandon markets, clients, suppliers or other entities in the value chain, but rather prefer that companies stay and work for improved conditions in the field of human rights and sustainability.

However, the SSMA is concerned that the fact that companies including regulated financial undertakings may face sanctions based on their turnover, as well as litigation under a new civil liability regime, potentially in courts in different Member States, will regardless of the intention behind the CSDD serve as a deterrent and potentially make companies abandon markets, clients, and suppliers.

Considering that CSDD supervisory authorities may be active in different areas, in different Member States, under different regulatory regimes, with different mandates and experience of investigative and other powers, the SSMA is seriously concerned that the CSDD will come to be interpreted, supervised, enforced, and sanctioned, in different ways in different Member States, leading to more fragmentation and an unlevel playing field, rather than to harmonisation.

6. Civil liability

CSDD in art 22 provides that Member States shall introduce a new civil liability regime which *inter alia* shall apply without prejudice to EU or national rules on civil liability and shall also have overriding mandatory application in cases where the law applicable to claims is not the law of an EU Member State.

The SSMA is concerned that the CSDD has very far-reaching and largely unpredictable consequences on companies including regulated financial undertakings, at the same time as the CSDD is in substance unclear and introduces new legal concepts.

The Commission further states in the background material that the risk of litigation is small, based on its experiences with existing regulations in Member States. However, the Commission also notes that several companies have been subject to trials for having caused, or failed to take actions against, negative effects at the level of the company, its subsidiaries, or in value chains.

The SSMA would in this context like to stress the importance of keeping in mind that the CSDD relates to topics that engage many companies, organisations, and citizens. To prove this point, reference is made to the Commission's statement that it received 473 461 responses and 122 785 signatures from citizens, and 149 position papers, on its consultation on sustainable corporate governance.

While the level of engagement from companies, organisations, and citizens in this field is commendable, the number of responses to the Commission consultation should remind us of the significant risk that legal actions, well founded or not, contrary to what is expected by the Commission, may well come to be initiated under a civil liability regime. This would in such case come at a high risk and potential cost, regardless of the ultimate outcome, for companies including regulated financial undertakings. It will also have budgetary and other implications for civil law courts in all Member States, even if as the Commission notes the parties to future disputes will carry their own costs. It

should also be kept in mind that the rules on costs and reimbursements may be applied differently in different Member States, adding to the uncertainty.

I could in this context be noted that the CSDD is intended to serve as a *lex generalis* regarding value chains and sustainability concerns that are not covered in the various sectoral initiatives. This means that *inter alia* deforestation in construction, mining, and environmental risks related to mining of conflict minerals would be covered by the CSDD.

Against this background, considering the unclarity, unpredictability and far-reaching potential consequences for companies as well as civil law courts in all EU Member States, the SSMA is strongly opposed to the introduction of a civil liability regime in the CSDD.

7. CSDD application to financial institutions

CSDD art 2 distinguishes between large EU limited liability companies, non-EU companies, and SMEs, and provides certain special rules for regulated financial undertakings.

The SSMA supports the concept of having special rules for regulated financial undertakings but consider that more discussion and clarity is required *inter alia* in the following areas.

7.1 CSDD vs other rules applicable to regulated financial undertakings

Regulated financial undertakings are subject to *inter alia* know your customer (KYC) and anti-money laundering and terrorist financing (AML) rules under which such undertakings are obliged to carry out a review or *due diligence* on clients and counterparties. It is however unclear if and to what extent such existing rules would be taken into account in relation to CSDD.

The SSMA would against this background like to see more clarity on how existing KYC and AML rules relate to the proposed due diligence regime under CSDD. The SSMA stresses the importance of not imposing additional administrative burdens and compliance costs on regulated financial undertakings.

7.2 Business relationship

The CSDD definition of “business relationship” and accordingly also of “established business relationship” include “financing, insurance or reinsurance” but does not mention other financial services.

At the same time the definition of “business relationship” refers to any relationship with a contractor, subcontractor, or any legal entities with whom the company has a “a commercial agreement”. It is thereby unclear if this wording covers other financial services or if the intention is to exclude other financial services when it comes to providing services to customers and only include the financing, insurance or reinsurance as services/products covered. Reference to “other financial services” is also made in article 6 item 3.

Further, as securities trading, investments and other similar activities regularly take place on regulated markets and/or with other entities supervised by financial supervisory authorities, the SSMA would

like to have clarified if and if so to what extent activities on such markets or with such supervised entities are covered by the CSDD.

Against this background, the SSMA would like to see further clarification in the recitals and legal text on whether the CSDD definition of “business relationship” and “established business relationship” apply to the activities of regulated financial undertakings, and if it does so apply to which extent, with the starting position of the SSMA being that the definition should not include activities by regulated financial undertakings.

7.3 Value chain

The CSDD provides that “value chain” in relation to regulated financial undertakings “shall only include the activities of the clients receiving such loan, credit and other financial services and of other companies belonging to the same group whose activities are linked to the contract in question.” It provides further that the “value chain of such regulated financial undertakings does not cover SMEs receiving loan, credit, financing, insurance or reinsurance of such entities.”

The SSMA notes that the list included in the definition is different from the one set out in the definition of “business relationship” and also notes that a differentiation is in the definition of “value chain” made between SMEs and other companies. It is also unclear if the reference to “commercial agreement” in the definition of business relationship means that all services-products are or may be covered.

The SSMA would against this background like to see further clarification how the description of financial activities in the definitions of “business relationship” including “commercial agreement” and “value chain” relate to each other and stress the importance of alignment of definitions not only intra-CSDD but also vis-à-vis other relevant rules applicable to regulated financial undertakings.

8. Code of conduct

CSDD art 7 – 8 (art 7 item 2b and 8 item 3 c) plus article 5 provides that companies shall adopt a code of conduct which shall be applied to entities in the value chain.

SSMA would like to see further clarity on how the code of conduct regime is expected to work in practice. Depending on how these rules are interpreted and applied in practice, the SSMA is concerned that companies including regulated financial undertakings will be requested or required to abide by numerous codes of conduct drafted to be applied in different business sectors. As a matter of fact, such requests are at times made already at present.

The SSMA considers that a solution to this situation could be that regulated financial undertakings, instead of having to provide information about their own codes of conduct or confirming that they apply codes of conduct not drafted for the financial sector, are required to publish information about their codes of conduct on their website.

Against this background, the SSMA would propose that it be clarified that clients of regulated financial undertakings are not required to request that such undertakings comply with the client’s code of

conduct. Instead, regulated financial undertaking would publish information about its own code of conduct which may be standardised *inter alia* by bank or other industry associations on its website.

9. Identification of actual and potential negative effects

CSDD art 6 discusses actions needed to identify certain actual and potential negative effects from a company's own or its subsidiaries' activities and in certain cases established business relationships. Art 6 (3) refers to checks required by financial firms before and when starting to provide financial services.

The SSMA considers that this provision is unclear and does not describe how far a company is required to perform its due diligence. Nor does it take into consideration if it is even possible for a company to perform such due diligence *inter alia* due to confidentiality agreements for employees.

The SSMA further notes that the following sentence in article 6 (4) is very far-reaching and create unpredictability and would like to see it removed from the CSDD: Companies shall, where relevant, also carry out consultations with potentially affected groups including workers and other relevant stakeholders to gather information on actual or potential adverse impacts.

Further, art 6 together with art 20 on sanctions may lead to situations where companies are sanctioned for lack of identifying "potential" human rights or environmental adverse impacts. Companies can thus be sanctioned for potential violations that have not occurred and may not occur. The word "potential", should thus be deleted from the text since it creates disproportionate legal uncertainty.

Considering the importance of these rules, the SSMA would like it to be further clarified when checks are required ahead of and during a business relationship.

10. Preventing potential adverse impacts and bringing them to an end

CSDD art 7 – 8 provides what companies need to do to prevent or where relevant bring an adverse impact to an end. It is further clarified that regulated financial undertakings do not have to terminate credits, loans or other financial service contracts when this could be reasonably expected to cause substantial prejudice to the entity to whom that service is being provided.

The SSMA supports the special rules set out in CSDD relating to regulated financial undertakings but stress the importance of providing further clarity regarding the meaning of these exemptions as well as around the interpretation of terms such as "substantial prejudice" and guidance around what is "substantial" in nature.

11. Combating climate change

CSDD art 15 sets out rules relating to the combating of climate change including remuneration rules of companies including regulated financial undertakings.

The SSMA notes that rules relating to climate change as well as remuneration regimes of companies including regulated financial undertakings are already at present included in several existing regulatory and self-regulatory regimes.

The SSMA would against this background and to avoid further fragmentation argue that rules in this field should not be included in the CSDD but should rather be dealt with in the context of other relevant regulations dealing with climate change and remuneration regimes.

12. Directors' duties and oversight

CSDD art 25 – 26 contain rules on directors' duties and oversight that have been significantly reduced and amended since the first drafts presented by the Commission.

At the same time, these rules will be implemented in 27 EU Member States with different corporate governance models. CSDD will also be applied on a company-by-company basis, meaning that many questions and unclarities will arise in different jurisdictions relating to the responsibilities and potential liability of board members. It is thus important that any rules set out in the CSDD in this regard refer to national rules on directors' duties and oversight.

Against this background, the SSMA is of the view that the responsibility and liability of boards and directors on boards should be further clarified and that such rules refer to what is generally prescribed for boards in each Member State.
