



ICGN

International Corporate Governance Network
Inspiring good governance & stewardship

Via submission: [Sustainable corporate governance \(europa.eu\)](https://european-council.europa.eu/europa-eu)

23rd May 2022

Dear President von der Leyen,

Re: Proposal for a DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on Corporate Sustainability Due Diligence and amending Directive (EU) 2019/1937 and Annex to the Proposal

The International Corporate Governance Network (ICGN) appreciates the opportunity to comment on the Proposal for a Directive on Corporate Sustainability Due Diligence and the amendment of Directive (EU) 2019/1937 (“Proposal”).

Led by investors responsible for assets under management of around \$70 trillion, ICGN is a leading authority on global standards of corporate governance and investor stewardship. Headquartered in London, our membership is based in more than 40 countries, with over 40% based in Europe, and includes institutional investors, companies, advisors, and other stakeholders ICGN offers an important international investor perspective on corporate governance and investor stewardship to help inform public policy development and the encouragement of good practices by capital market participants. For more information on the ICGN, please visit www.icgn.org.

ICGN’s mission is to advance the highest standards of corporate governance and investor stewardship worldwide in pursuit of long-term value creation, contributing to healthy and sustainable economies, society, and the environment. This mission is advocated in the ICGN Global Governance Principles¹ (“ICGN GGP”) and the ICGN Global Stewardship Principles (“ICGN GSP”)² which form the basis of ICGN’s work programme around the world. The ICGN GGP is referred to by many members in their voting policies and company engagements. Both the ICGN GGP and the ICGN GSP are also used by regulators as an international benchmark in the development of national policies.

ICGN largely supports the proposed revisions, and we appreciate that our commentary offered in previous European Commission comment letters appears to have been considered. We also appreciate that the Proposal has been drafted to supplement the requirements from recent legislation and should be fully aligned with the SFDR, the Taxonomy Regulation, and the CSRD proposal.³

¹ [ICGN Global Governance Principles 2021](#) (2021)

² [ICGN Global Stewardship Principles | ICGN](#) (2020)

³ EU Proposal, pp. 4-5.

To provide further comments, we have organised our response to the Proposal, which are grouped into the areas of review.

Article 1 Subject matter and Article 2 Scope.

The Directive introduces rules (a) on obligations for companies regarding actual and potential human rights adverse impacts and environmental adverse impacts, with respect to their own operations, the operations of their subsidiaries, and the value chain operations carried out by entities with whom the company has an established business relationship and (b) on liability for violations of the obligations mentioned above.

ICGN agrees with the EU that these are serious matters for corporate boards to consider as companies integrate sustainability considerations in the management and governance process. However, as noted in previous ICGN commentary, we continue to caution against prescriptively codifying how this is best achieved. We refer you to ICGN's letter in response to the EU's sustainable corporate governance consultation in 2021⁴, where we emphasised that this may be more a matter for soft law than hard law regulation.

Global systemic events such as climate change, the COVID19 pandemic and rising geopolitical threats have further emphasised the need for corporate boards to understand the nature of these systemic risks and the degree to which this impacts issues such as human rights abuses in the supply chain, poor environmental and health & safety standards, and other practices that are adverse to society and investors.

As a matter of corporate governance ICGN encourages companies and boards to establish their own bespoke comprehensive due diligence processes that continuously monitor systemic risks. In Guidance 6.2 Comprehensive approach of the ICGN GGP, it states:

The board should adopt a comprehensive approach to the oversight of risk which should be enterprise-wide and include threats to the company's business model, cyber-security, supply chain resilience, performance, solvency, liquidity, and reputation. Risk oversight should extend beyond financial capital to include human capital and natural capital and in particular, systemic risks identified in the United Nations Sustainable Development Goals, where these are relevant to the company's business model and strategy. Fundamental to this is the board's agreement on its risk appetite, and the board should seek to publicly communicate this in basic terms.⁵

In particular, Guidance 4.7 of the ICGN GGP refers specifically to human rights and states:

"The Board should ensure that it is sufficiently informed of how human rights and modern slavery issues may present material business and reputational risks or might compromise a company's own values and standards of behavior. The Board should establish appropriate due diligence processes, strategy, disclosure, engagement, accountability and other measures to deal with human rights issues which may materialize in connection with the company's workforce and operations."

The adoption of this guidance could help improve a company's environmental performance and accountability for social practices. The failure of corporate boards and management to address

⁴ [3. ICGN response to Sustainable Governance EU Consultation 2021.pdf](#), February 8, 2021.

⁵ [ICGN Global Governance Principles 2021](#), p. 24.

these systemic risks has widespread consequences for corporate reputation, that may involve fines and penalties, and impact their ability to attract talent and capital for company growth.

With respect to Article 2, Scope, ICGN recommends that companies operating in the EU as smaller enterprises⁶ are included in the Scope, and be required to report on actual and potential human rights adverse impacts and environmental adverse impacts, with respect to their own operations, the operations of their subsidiaries (if any), and their value chain operations. This is particularly important given that smaller enterprises may have more constraints in sourcing labor and tracking their operations down the supply line. Due to the reporting requirements, smaller enterprises could be given a time frame of up to two years to report on their operations. ICGN supports the Statement from the Investor Alliance for Human Rights⁷ calling for the regulation to be “cross-sectoral, covering all business enterprises and financial institutions, public and private, domiciled or based in, operating, or offering a product or service within the EU. Critically, it should cover small as well as large businesses, recognising that they are part of the same value chain.”⁸

With respect to another aspect of the scope of the Proposal, it may be useful to include third-country companies operating in the Union market place, based on a similar criterion, with the caveat that the EU should consider the complexities for large foreign groups with subsidiaries operating in the EU. We also recognise and support the rationale for inclusion of temporary agency workers in the overall calculation with full time workers. In this way, companies will not be able to revert to hiring through employment agencies to avoid meeting the Directive’s criteria.

Article 4 Due diligence and Article 5 Integrating due diligence into companies’ policies.

ICGN supports the incorporation of a due diligence review into all company policies, including the roles of the board and management. The ICGN GGP advocates that corporate boards are responsible for overseeing the company’s risk assessment and management (including relevant systemic risks such as climate change, ecological degradation, social inequality and digital transformation) that affect sustainable value creation and preservation and reviewing policies annually, or with any significant business change.”⁹

ICGN recognises that there are prescriptive requirements in the Directive regarding the due diligence policy, and we emphasise our preference for a soft law approach to this board responsibility so that it can be applied flexibility to allow companies to create their own bespoke policies depending on its business operations. The full integration of due diligence reviews within company policies is essential to understanding and mitigating potential adverse impacts. Human rights and environmental concerns can lurk in the background without being discovered,

⁶ Proposal which provides, “beyond the requirement of more than 500 employees on average and a net worldwide turnover of more than EUR 150 million in the last financial year or the company did not reach the thresholds under point (a), but had more than 250 employees on average and had a net worldwide turnover of more than EUR 40 million in the last financial year for which annual financial statements have been prepared, provided that at least 50% of this net turnover was generated” in certain sectors, pp 46-47.

⁷ Investor Statement in Support of Mandated Human Rights and Environmental Due Diligence in the European Union, [Investor Statement in Support of Mandated Human Rights and Environmental Due Diligence in the European Union | Investor Alliance for Human Rights \(investorsforhumanrights.org\)](#), 94 investors representing over \$6.3 trillion in assets under management and advisement.

⁸ Ibid.

⁹ [ICGN Global Governance Principles 2021](#),. p. 6.

either based upon a lack of oversight at the corporate board level or a clear effort to avoid transparency by third-parties.

With respect to publicly communicating a company's due diligence process, ICGN agrees that full transparency is the best approach in order to ensure regulators, investors and stakeholders that companies have taken the responsibility seriously and are able to benchmark progress meeting these objectives. ICGN agrees that Member States should ensure that the companies review their due diligence policy annually or on an as needed basis.¹⁰

Article 6 Identifying actual and potential adverse impacts, Article 7 Preventing potential adverse impacts, and Article 8 Bringing actual adverse impacts to an end.

These three Articles are significant sections of the Directive that require companies to act to end or prevent adverse impacts. While it is important for companies to create policies and provide for the due diligence review, analysing the due diligence information and taking any required action are essential. The Directive requires that Member States ensure that companies “take appropriate measures to identify actual and potential adverse human rights impacts and adverse environmental impacts arising from their own operations or those of their subsidiaries and, where related to their value chains, from their established business relationships.”¹¹

Prevention of adverse impacts may be the best strategy by identifying these risks and creating the plan to address them, which is the focus of Article 6. Mitigation of risks and adverse impacts, if necessary, is an important step that should help companies monitor the effectiveness of their policies and due diligence processes in place. Monitoring of these programmes should be continuous. According to the ICGN GGP, Guidance 4.5 Behaviour and conduct:

The board should foster a corporate culture which ensures that management, the workforce, and the board itself, act with integrity and understand their responsibility for appropriate behaviour and ethical conduct facilitated through codes and training. Due diligence and monitoring programmes applicable to the board should facilitate understanding of codes of conduct and help ensure effective adoption and application.¹²

With regard to Article 8 and its requirement that companies “shall be required to take the following actions,” to bring actual adverse impacts that have been, or should have been, identified to an end, ICGN has reservations on the Article's requirement that one of the six actions listed be taken.¹³ The overarching responsibility for addressing impacts lies with the company's board and management as mentioned in the Article, which must act to fulfill its obligation to investors and society. In responsibly exercising that duty, a company may be able to address adverse actions in other ways and should not be precluded from using an alternative method.

Article 9 Complaints procedure, Article 10 Monitoring, Article 23 Reporting of breaches and protection of reporting persons.

Directive (EU) 2019/1937 shall apply to the reporting of all breaches of this Directive and the protection of persons reporting such breaches. ICGN is supportive of the Proposal's efforts to

¹⁰ [ICGN Corp Risk Oversightweb](#), 2015, p. 16.

¹¹ EU Proposal, pp. 55-56.

¹² [ICGN Global Governance Principles 2021](#), p. 19.

¹³ EU Proposal, pp. 56-57.

protect anyone or an organisation that submits complaints when they have legitimate concerns that human rights violations or environmental impacts may not be known by the company or are being addressed by the company and/or its suppliers. The Proposal also requires that Member States ensure that companies are carrying out assessments at least every 12 months of their operations, suppliers, and value chains. The assessments should be comprehensive enough to identify new risks and mitigate any discovered adverse impacts.

ICGN supports efforts by the EU to protect those who report or whistleblowers who can take on serious responsibilities to report breaches of law and internationally agreed principles that could impact investors, customers, employees, and communities. In an ICGN Viewpoint on “Human Rights through a Corporate Governance Lens”, we discussed reporting on human rights issues and its relevance for companies, investors, and stakeholders:

Reporting on human rights issues is an important means for companies to build awareness, both internally and to external stakeholders, including investors, about how a company approaches the management and governance of these issues. This is relevant not only for company sustainability reporting, but also for integrated reporting in cases where human rights represent a material business or reputational risk.¹⁴

ICGN also recognises that the OECD Guidelines for Multinational Enterprises contain an operational-level grievance mechanism, which could provide companies with another way to establish a grievance mechanism for the reporting of complaints.¹⁵

Article 13 Guidelines, Article 14 Accompanying measures.

The Proposal provides that guidelines for specific sectors or specific adverse impacts may be issued to assist companies, and Member State authorities, as they work to fulfill their due diligence obligations. ICGN appreciates that the Proposal also recognises that small and medium business enterprises (SMEs) may have a need for additional assistance because they may be part of the value chains of larger companies. One business chain may include many companies. Through a comparable due diligence review, these companies may find ways to identify and mitigate human rights violations and environmental impacts.

ICGN is supportive of the issuance of guidelines to assist with compliance. In a similar way, ICGN has issued policies and guidance intended to provide internationally accepted standards to help inform the adoption of and continuous evolution of corporate governance and stewardship codes.¹⁶

Article 15 Combating climate change.

ICGN has commented extensively on the need for the global community to address climate change as articulated in our letters to regulators¹⁷ and also as defined in our Statement of Climate Change Responsibilities.¹⁸ We agree that Member States should ensure that

¹⁴ ICGN Viewpoint, [Human rights through a corporate governance lens.pdf \(icgn.org\)](#), April 2015, p. 4.

¹⁵ [48004323.pdf \(oecd.org\)](#), pp. 53-54.

¹⁶ Preamble, [ICGN Global Governance Principles 2021.pdf](#), p. 4.

¹⁷ For a comprehensive letter, please see 1. a. Canada - CSA Climate Disclosure Letter Ontario, Jan 2022.pdf (icgn.org), January 27, 2022.

¹⁸ ICGN Statement on Shared Responsibilities, https://mcusercontent.com/a18220954c0ba317f575a2cb8/files/f82bafd8-14e2-bb45-7792-0766f13c345d/ICGN_Statement_on_COP_26_ENG_Oct_20_2021.01.pdf

companies adopt plans to provide for changing business models and develop long-term strategies to transition to a sustainable economy. We understand that the Proposal requires that companies should include emission reduction objectives in the plan if climate change has been identified as a principal risk or will have a material on the company's operations.

Climate-related reporting is specifically referred to in the ICGN GGP Guidance 7.5 as follows:

The board should assess the impact of climate change on the company business model and how it will be adapted to meet the needs of a net zero economy as part of a long-term strategy. This includes setting and disclosing targets to reduce carbon emissions and a period for achievement. Where climate change risks, whether physical or transitional, are identified as material and relevant, reporting should include discussion of the diligence process, strategy, metrics, targets and initiatives used to manage the risks. Disclosure around these actions would help investors understand the resilience of companies facing climate change risks and to assess progress towards achieving net zero targets.¹⁹

ICGN's position on the application of materiality tests to climate disclosures is evolving. Given the double materiality implications of climate change, we recommend that governments should consider whether carbon-intensive industries should be subject to mandatory climate disclosures. This approach would recognise the scientific consensus that the environmental, social and economic impacts of climate change are evident today and will only intensify in the future.

While the Proposal does include consideration of climate change, ICGN believes it could go further and require that companies include emission reduction objectives and assurance by qualified third-party auditors on the company's plan to address principal risks or will have a principal impact on the company's operations. Adverse impacts related to climate change should be included in the due diligence review process, in which a company should firstly prevent and, if necessary, mitigate any adverse impacts.

In addition, the Proposal seeks action by Member states to ensure that companies take climate risks into account when setting variable remuneration. ICGN has widely discussed the need to link executive remuneration with a company's business strategy, long-term interests, and sustainability. We agree that linking remuneration to business risks, including climate-related risks, is an important element of executive remuneration plans.²⁰ The wisest approach is to adjust climate or other sustainability measures for variable remuneration according to their material impact on each company; climate risk may be more or less material in differing companies depending on the companies' sectors and business operations.

¹⁹ [ICGN Global Governance Principles 2021.pdf](#), p. 27.

²⁰ Principle 5, Remuneration, [ICGN Global Governance Principles 2021.pdf](#), pp. 20-23. See also <https://www.icgn.org/sites/default/files/2021-06/ICGN%20Viewpoint%20Board%20of%20Directors%20and%20Climate%20Change.pdf>; <https://www.icgn.org/sites/default/files/2021-06/ICGN%20Viewpoint%20COVID-19%20and%20Executive%20Remuneration.pdf>

Article 25 Directors' duty of care.

We support this Article in the Proposal, which requires that Member States ensure that directors of companies take into account the consequences of their decisions for sustainability matters, including, where applicable, human rights, climate change and environmental consequences, including in the short, medium and long term. In our view this is a matter of governance within the context of the overarching fiduciary duty of directors to promote the success and resilience of the company to preserve and enhance corporate long-term value for the benefit of shareholders and relevant stakeholders, and ultimately contributing to sustainable economies, societies, and the environment. In this way we see a (positive) resemblance with Section 172 of the UK's 2006 Company Act, which similarly articulates the need for directors to 'have regard for' stakeholder interests as part of their duty to promote overall company success.

In a similar point that has been raised elsewhere in this letter, if this duty of care is to be required for companies by law, we believe that companies should have the flexibility to develop their own approaches to this, which reflect the company's endogenous qualities. A more prescriptive requirement could result in an empty compliance exercise, or even result in unintended consequences.

The role of a board of directors is one of good faith, care, and loyalty. The first principle in the GGP, Principle 1, Board role and responsibilities, states, "The board should promote the long-term best interests of the company by acting on an informed basis with good faith, care and loyalty, for the benefit of shareholders, while having regard to relevant stakeholders."²¹

It is essential that Member States ensure that boards of directors take into account the actions of the company with respect to human rights, climate change and any environmental consequences. These actions may be financially material and therefore have an impact on the viability of the company over the short and long-term.

Whilst ICGN acknowledges that most directors understand this responsibility and act accordingly, there are examples of failures of board members to act as fiduciaries. The Proposal should provide for a mechanism to assess a breach of directors' duties with regard to the provisions of these Articles.

Article 26 Setting up and overseeing due diligence.

ICGN supports this Article, however, we recommend that the EU considers *investors* as well as stakeholders and civil society organisations in the following language, "Due consideration by boards of directors should be given for input that is offered from "stakeholders and civil society organizations" *as well as investors,*" in addressing the requirements in the Proposal.

We also note that the Article contains this language, "The directors shall report to the board of directors in that respect," which refers to directors of companies in Article 2(1). ICGN would ask that this phrase be clarified to explain whether senior executives or individual board members are the "directors" referenced who should report to the board.

In the ICGN GGP, Guidance 1.4 Dialogue., the board is encouraged to engage in constructive dialogue with investors and relevant stakeholders:

²¹ [ICGN Global Governance Principles 2021.pdf](#), p. 6.

The board, particularly the chair, lead (or senior) independent director and committee chairs, should constructively engage with shareholders and relevant stakeholders (particularly the workforce) for meaningful dialogue. This infers two-way communication between companies and shareholders/ stakeholders and not a unilateral presentation from just one party. Such dialogue should encompass all matters of material relevance to a company's governance, strategy, innovation, risk management and performance as well as environmental and social policies and practices.²²

Whilst every board should be able to determine how to accomplish this outreach, it is important to report on the input received and actions taken by the board. In this way, companies, investors, and stakeholders may work together to resolve any human rights issues, environmental impacts or other systemic risks that could cause long-term harm to the company.

Thank you for the opportunity to provide our perspective on the Proposal. If you would like to follow up with questions or comments, please contact me or ICGN's Policy Director, George Dallas at George.dallas@icgn.org.

Yours faithfully,



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²² [ICGN Global Governance Principles 2021.pdf](#), p.10.