

**ICGN**

International Corporate Governance Network
Inspiring good governance & stewardship

ICGN Statement on Proposed European Union Corporate Sustainability Due Diligence Directive

24 April 2023

As the European Union (EU) proceeds towards finalisation of the Corporate Sustainability Due Diligence Directive (CS3D), the International Corporate Governance Network (ICGN) offers this statement of support and provides four main recommendations focusing on definitions, executive remuneration, board responsibilities, and global standards.

The CS3D seeks to provide companies with clear guidance on due diligence procedures that will support and advance both the Corporate Sustainability Reporting Directive (CSRD) and the Sustainable Finance Reporting Directive (SFDR). It will set the standard and provide useful guidance for companies around the world seeking to enhance internal procedures even if not subject to EU legislation. ICGN was pleased to provide a submission to the European Commission on the proposed CS3D in May 2022.¹ At this time, we wish to further articulate our views noting the rapid evolution of many of the concepts and approaches related to the governance of corporate sustainability. We offer four main recommendations.

1. Article 3 of the Directive should consider including a definition of corporate sustainability as there is considerable market and public confusion regarding the meaning of this term. We suggest adoption of the definition recently released by the International Sustainability Standards Board in December 2022: “the ability for a company to sustainably maintain resources and relationships with and manage its dependencies and impacts within its whole business ecosystem, over the short, medium, and long term. Sustainability is a condition for a company to access over time, the resources and the relationships needed (such as financial, human, and natural capital), ensuring their proper preservation, development, and regeneration to achieve its goals.”²
2. Article 15 specifies that companies should link variable remuneration to the fulfilment of goals with respect to climate change and the transition to a sustainable economy limiting global warming to 1.5C in line with the Paris Agreement. ICGN supports such targets but also maintains that companies should consider linking variable remuneration, when material, to additional sustainability goals related to both natural and human capital. We note that in designing such remuneration structures, companies should ensure that executives are rewarded for the achievement of clear, significant, and quantifiable goals but not for sustainability-related activities that would have occurred absent variable pay.³
3. Article 26 provides two brief provisions on the role of the board in setting up and providing oversight of due diligence actions (as specified in Articles 4 and 5) and taking steps to adapt the corporate strategy to take into account actual and potential sustainability impacts (Article 6). We suggest that companies subject to the Directive would benefit from more specificity regarding the governance of sustainability. In this regard we note that the CSRD cites the ICGN Global Governance Principles, alongside the G20-OECD

¹ EU - Consultation on Corporate Sustainability Due Diligence, May 2022.pdf (icgn.org).

² <https://www.ifrs.org/news-and-events/news/2022/12/issb-describes-the-concept-of-sustainability/>

³ ICGN Global Governance Principles, Principle 5.3. <https://www.icgn.org/icgn-global-governance-principles>.

Principles, as an authoritative global corporate governance framework of most relevance to users.⁴ We recommend that the CS3D make specific reference to these instruments and, noting the rapid evolution of high standards in the broad field of sustainability, consider specifying the main components of board-specific sustainability due diligence.⁵ These include:

- identifying the board and/or board committee responsibility for oversight of sustainability-related risks and opportunities;
- ensuring that responsibilities are specified in committee terms of reference and board mandates;
- defining the board's role in establishing corporate purpose, mission, values and culture, as these relate to sustainability;
- establishing procedures for integrating sustainability considerations into enterprise risk management, strategic planning, major transactions, and capital allocation;
- establishing board procedures for setting targets related to sustainability risks and opportunities and the monitoring of progress towards them;
- ensuring that performance on material sustainability metrics and challenges are incorporated into director and chief executive officer annual evaluations;
- incorporating categories of material sustainability risks and opportunities into the board's matrix for determining board competencies and anticipating the recruitment of new directors;
- specifying procedures for establishing and developing appropriate sustainability skills and competencies including director training;
- specifying the board's role for company engagement of relevant stakeholders; and,
- establishing calendars to specify the frequency with which the board and relevant committees are informed about sustainability risks and opportunities.

4. Finally, ICGN notes the global nature of our membership, investment institutions, capital markets, and initiatives to advance common corporate sustainability expectations. Whenever we engage policy-makers and other standards-setters on governance, stewardship and sustainability we underscore the need to establish global due diligence and reporting standards that are consistent, supportive, and provide inter-operability for companies seeking to advance their sustainability performance worldwide. For this reason, we greatly appreciate the efforts of EU institutions to build on established protocols first provided by the United Nations Guiding Principles on Business and Human Rights and the OECD Guidelines for Multinational Enterprises. Further, we support efforts made to complement a wide range of existing and planned EU regulations including legislation on climate change and energy transition, conflict free minerals, human trafficking, and the European Green Deal as well as the CSRD and SFDR. ICGN welcomes the alignment of this Directive with these standards and are hopeful that other standards-setters around the world will also consider inter-operability as the corporate sustainability agenda continues to advance.

⁴ <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32022L2464>. Many ICGN Members refer to the ICGN Global Governance Principles in their corporate governance assessments, proxy voting policies, and company engagements. The Principles also inform governments and regulatory agencies on internationally accepted standards to help inspire the evolution of national corporate governance codes.

⁵ <https://www.icgn.org/governance-sustainability-investor-view-board-effectiveness>. ICGN notes that these provisions further articulate those specified in the Draft European Sustainability Reporting Standards 2, General Disclosures, November 2022: <https://www.efrag.org/Assets/Download?assetUrl=%2Fsites%2Fwebpublishing%2FSiteAssets%2F07.%2520Draft%2520ESRS%2520%2520General%2520disclosures%2520November%25202022.pdf>.

The ICGN commends the EU for its leadership on setting both sustainability reporting and due diligence standards in Europe. We are hopeful that the final version of the Directive, to come into effect in 2026, may reflect the comments we have provided.

About ICGN

Established in 1995, ICGN's purpose is to convene capital market participants to develop, promote and embed high standards of corporate governance and investor stewardship worldwide to preserve and enhance long-term value, contributing to sustainable economies, societies, and the environment. ICGN Members, many of whom are investors responsible for assets of around \$70 trillion, are based in over 40 countries - largely in Europe and North America, with growing representation in Asia. For more information visit www.icgn.org

Contact

Please contact the ICGN Secretariat if you have comments or questions about this Statement by email at kate.webster@icgn.org.