Will the Spanish EU Presidency go down in history for missing a golden opportunity to introduce sustainability due diligence for the financial sector, Europe's only hope of stopping the flow of trillions of Euros currently financing human rights violations and nature destruction?

Why a standardised due diligence framework for the financial sector will help European companies, reduce risk for the financial sector and incentivise sustainable business practices well beyond Europe.

WHAT IS THE PROBLEM?

In the run-up to reaching an agreement before Christmas, the negotiations on the Corporate Sustainability Due Diligence Directive (CSDDD) a.k.a. "EU supply chain law", reached a turning point.

On 10th November, the Spanish Presidency proposed to the Council to exclude the entire financial sector from the scope of the CSDDD. On 15th November, EU Ambassadors reached a consensus on adopting the Presidency's proposal. The next Political Trilogue on 22nd November is therefore set to exclude financial institutions (FIs).

It was **France who pushed for the full exclusion of the financial sector** from the CSDDD. Others, like Germany, Ireland, Italy and Luxembourg, had proposed the exclusion of institutional investors and asset managers, limiting the Directive's scope to financial institutions that have a **contractual relationship** with their clients (i.e. banks and insurers).

However, numerous FIs have stressed that they want to be included in the CSDDD: Institutions such as the UN PRI, IIGCC, Eurosif, the Dutch Banking, Insurance and Pension associations, Danish investors, Frank Elderson (Member of the Executive Board of the ECB), ASN Bank and ABN AMRO have publicly spoken out already.

The CSDDD is the one incentive for financial institutions to stop financing harmful activities hidden in their clients' and investees' **value chains.** Yet, trillions of financing goes to high environmental and human right risk sectors, largely to companies without proper environmental policies or commitments in place[1].

Ultimately, it is these specific investment, financing and insurance decisions that enable environmental destruction – or protection. About 80% of natural capital destruction associated with large listed companies is hidden in the value chain; for the food and beverage sector, it is even 98%![2]

Voluntary actions have **not delivered: clear rules and incentives are missing**. The CSDDD could and must close this gap for the financial sector. The Council is now proposing to strip the EU of its unique opportunity to put in place **concrete incentives** for the financial sector to take responsibility about its financing of environmental and social destruction.

WHY THE CSDDD MAKES SENSE FOR FINANCIAL AND NON-FINANCIAL COMPANIES

Not only would the CSDDD create incentives for financial and non-financial companies across the EU to address the global impact of our value chains, but it would also create the missing framework to make sustainability due diligence work for all.

1) Making it work for the real economy

The financial sector most often uses engagement over divestment when it comes to their sustainability strategy. Without coherent due diligence obligations for FIs, sustainability engagement of financial market players will not be coherent and could become a nightmare for investees and clients. Including financial institutions in the CSDDD is the opportunity to make the life of our companies easier in times of crisis.

[1] Example of even just financing of deforestation: Forests & Finance (2022), link ; Forest500 (2023), link
[2] UN Principles for Responsible Investment (2017), link.

2) Making it work for the financial sector

The financial sector already faces certain *implicit* sustainability due diligence duties through the Corporate Sustainability Reporting Directive (CSRD) and the Sustainable Finance Disclosure Regulation (SFDR). However, these duties come without clear guidance and clarity about **what is expected of the financial sector** and **how to deal with identified impacts.** The policy coherence and guidance that the CSDDD would create could largely reduce their burden, their uncertainties, and thus their liability risks.

3) Making it work for partner countries – and getting them on board

Having been a frontrunner for decades, the EU needs to engage its partners to reach its common human rights, biodiversity and climate change objectives. And the majority of the EU's environmental and social footprint has shifted to *global* supply chains; and regulatory measures such as the CBAM, the EU Deforestation Regulation (EUDR), are a clear signal that the EU is acknowledging this shift.

Tackling this challenge requires international co-operation, yet existing channels to facilitate those conversations, such as the WTO and G20, are struggling. The CSDDD provides a clear framework for concrete, bottom-up engagement along our global value chains, and the financial sector with its global reach and leverage needs to be part of this process.

In order to get partner countries on board, two things are key:

- **Feasibility:** As for non-financial companies in Europe, having one set of clear financial sector engagement rules makes sustainability due diligence feasible for companies outside Europe, upstream in the supply chains.
- **Credibility:** By adopting sustainability due diligence obligations for the financial sector, Europe sets an international global benchmark, increasing the pressure for others to follow suit.

In summary, the essence of CSDDD is to create a **level-playing field and clear engagement framework for all financial and non-financial companies** across the EU and beyond. The Council is now proposing to *eradicate* this level-playing field, and to strip the EU of its unique opportunity to put in place concrete incentives for the financial sector to stop financing environmental and social destruction. This decision will create confusion in the market, increase risks for the financial sector and hamper international cooperation and buy-in by partner countries for the sustainability transformation.

HOW TO MAKE THE CSDDD FEASIBLE FOR THE FINANCIAL SECTOR

The inclusion of FIs in the CSDDD[3] will be effective only if we ensure the **feasibility** of their value chain due diligence obligations. There are three elements which are crucial to ensure that the CSDDD works for FIs:

- **Require FIs to build on the due diligence procedure of their clients/investees**. It is not doable to ask FIs to *find out* about the value chain of their clients and the related environmental and social impacts. FIs should build on already available information from their clients, check the quality and robustness of their impact assessment, and assess whether the impact mitigation measures are adequate. FIs should use this information as a basis to comply with their requirements in the CSDDD, and for their KYC (know-your-customer) procedure because deforestation risk can become a material risk for the FI.
- **Delay the start of application of the CSDDD for FIs**. A phase-in approach is key to allow FIs to make use of the due diligence procedure of their clients. While still included in the actual CSDDD, FIs should only have to start applying the CSDDD one or two years after the start of application for the real economy.
- **Follow a risk-based approach**. As proposed by both the EU Parliament and Council, FIs should prioritise their assessment of and engagement in high-risk areas based on the *severity* of the impact and *leverage* of the FI regarding the impact.

[3] A compromise between the EU Commission, Parliament and Council could be to review the inclusion of investors at a later stage, and initially focus on including banks and insurers.