



Eumedion response - Call for feedback on the Platform for Sustainable Finance's report on minimum safeguards

6 September 2022

Link to report:

https://ec.europa.eu/info/sites/default/files/business_economy_euro/banking_and_finance/documents/draft-report-minimum-safeguards-july2022_en.pdf

[Full text of the questionnaire with draft Eumedion response in red]

Introduction

The report on minimum safeguards is intended to provide advice on the application of the minimum safeguards (MS) which bring a social and governance component to the EU taxonomy. The MS are mentioned in Article 3 of the Taxonomy Regulation (TR) as one of the criteria for environmentally sustainable activities, and are further defined in Article 18. The advice in the Report is structured by a) embedding the MS in existing EU regulation, b) identifying the substantive topics of the standards and norms referenced in Article 18 of the Taxonomy Regulation and c) by working out how compliance with MS can be established.

Analysing the standards referred to in Article 18 of the TR (OECD guidelines for multinational enterprises (MNE), UN guiding principles on business and human rights (UNGP), the eight conventions on fundamental principles and rights at work and the international bill of human rights), the report identifies four core substantive topics for which compliance with minimum safeguards has to be defined. These four topics are:

1. Human rights including workers' rights and consumers' rights
2. Bribery/corruption
3. Taxation
4. Fair competition

The advice on these four topics is worked out close to the standards referenced in Article 18 TR and to upcoming EU regulation which is built on these same standards, the Corporate Human Rights Due Diligence Directive (CSDDD) and the Corporate Sustainability Reporting Directive (CSRD) and the respective disclosure requirements. As both are still not yet fully finalised there remains some uncertainty as to their implementation. Therefore, the solution developed in this report is to a) build the requirements for MS compliance on the international standards referenced in Article 18 and especially on the six steps of the UNGPs/OECD guidelines for MNE, b) point to upcoming regulations and disclosure requirements that build on these standards and c) to point to independent sources of

information covering particular aspects of MS implementation which could be used for external performance checks.

More concretely the report advises to consider the following as a sign of non-compliance with MS

1. inadequate or non-existing human rights due diligence processes in companies including labour rights, bribery, taxation and fair competition
2. a company's final conviction in court, if it is related to any of the above listed topics
3. a lack of collaboration with a national contact point (NCP) or an assessment of non-compliance with OECD guidelines for MNE by an OECD NCP
4. a company not responding to allegations raised by the Business and Human Rights Resource Centre

It is further suggested that points two to four should be valid until the company has implemented a due diligence system that makes such breaches unlikely.

On the basis of this advice, the EU Platform on Sustainable Finance would like to solicit public feedback on the following questions.

Your opinion

The Report proposes two sets of criteria for the establishment of non-compliance with MS: one related to adequate due diligence processes implemented in companies (i.e. relying on corporate reporting and disclosure) and the other related to the actual outcome of these processes or the company's performance (i.e. relying on external checks on companies).

Question 1. Do you agree with this two-pronged approach?

Yes; No; Don't know / no opinion / not applicable

Please explain why you do not agree with this two-pronged approach:

5000 character(s) maximum

We agree with the two-pronged approach, but we have some serious concerns regarding the feasibility of the PSF's advice on how to operationalize the second prong of the suggested approach. We refer to our answer under question 3 for a detailed explanation and our alternative solution.

The advice of the report is that companies covered in the future by the EU due diligence law (the proposed CSDD Directive) which are acting in compliance with the law would be considered aligned with the human rights part of the minimum safeguards as the demands of these two legislations overlap (provided that the final scope and the requirements of CSDDD will indeed be aligned with the standards and norms of Taxonomy Regulation Article 18).

Question 2. Do you agree with this advice of the report?

Yes; No; Don't know / no opinion / not applicable

Please explain why you do not agree with this advice of the report:

5000 character(s) maximum

n/a

The UNGPs require that due diligence processes implemented in a company result in human rights UNGPs abuses being effectively prevented and mitigated. To check whether processes implemented in a company fulfil this requirement, the report suggests applying external checks based on a company

- a. having had a final conviction at court
- b. or not responding to complaints at OECD national contact points or allegations via Business and Human Rights Resource Centre.

Question 3. Do you agree with this approach?

Yes; **No**; Don't know / no opinion / not applicable

Please explain your answer to question 3:

5000 character(s) maximum

We fully agree with the first requirement to have adequate due diligence processes in place and the alignment with CSRD (and future CSDDD) requirements in this respect. This part is 'relatively easy' to assess. But it is different when it comes to establishing non-compliance in terms of actual outcome.

The consequences of labelling a company non-compliant with the MS are potentially very large, i.e. exclusion from Taxonomy-aligned investment portfolios and all of the consequences this may entail. However, the MS are an integral and very important element of the Taxonomy, so the development of a harmonized approach is absolutely warranted. Therefore, a thorough process and clear, objective criteria (including a materiality assessment) are required. In the absence of these, it will be impossible for fund managers to consistently and comparably assess non-compliance with the MS.

Eumedion believes that the approach regarding actual outcomes, as meant under question 3, can certainly be *indicative* of non-compliance with the MS, and should as such be taken seriously by investors. However, as a final criterium to determine non-compliance, the suggested approach is not suitable.

First of all, we identify various key obstacles in relation to establishing non-compliance through a final court conviction. A final conviction at court may not necessarily objectively establish a violation or the extent or the materiality of non-compliance. It would require a much broader assessment, not only in terms of type of court case, but also in terms of materiality of the non-compliance issue at hand. To determine materiality, a methodological link should be established with the CSRD ESRS exposure drafts, which similarly relies on a materiality assessment regarding actual and potential adverse sustainability impacts to determine which impacts are material for a company and should therefore be reported on. This allows for further granularity when determining whether a case of potential non-compliance is in a company-specific material area (see also our answer to question 3.2) and this would contribute to assessing the scope of the final court conviction (as this could vary from a 'simple' breach to severe violations). This also applies to the scope in terms of parent company versus subsidiaries: should *all* economic activities of the company be disqualified following a final court conviction? Additionally, it could take years for a court conviction to become final – which could mean that a violation may persist in the absence of a final conviction, but it could equally mean that in the meantime due diligence procedures have been adequately adjusted to avoid any future violations.

Secondly, any cases considered by an NCP, or when companies are not engaging with stakeholders, or other comparable types of allegations/investigations: those would be part of a 'soft law'

construction. Regardless of the merit of such instances or of the question of how to assess the merit of such instances in light of compliance with the MS, it would be undesirably to have 'soft law' instruments determine the outcome of a 'hard law' requirement.

The above means that the suggested approach in our view lacks precision where it concerns not only legal clarity, but also materiality. This means that, in practice, it would lead to legal uncertainty and potentially random outcomes for companies subject to Taxonomy-assessment, while facing any consequences that arise from not being Taxonomy-aligned. We would in any case be very interested to also learn which other methods (if any) the PSF has considered towards assessing MS, and how these were weighed.

We refer to our answer under 3.1 for our alternative suggestion on how to approach this issue.

Question 3.1 Which type of court cases should be selected as criterion for non-compliance with minimum safeguards?

5000 character(s) maximum

As stated under question 3, we sincerely doubt whether through a criterium of 'type of court cases' alone a suitable determinant of non-compliance can at all be defined. Determining non-compliance would require a broader assessment of objectively established violation and negative impact (is this per definition established by a conviction by any court worldwide?), of materiality, of mitigation, remediation and prevention of violations, and of the due diligence procedures already in place.

Therefore, alternatively, an approach may be developed where the various indicators (final conviction, NCP complaints, etc.) are mandatory input to a more comprehensive assessment of potential non-compliance, aimed at objectively establishing a violation and negative impact (is this per definition established by a conviction by any court worldwide?), of materiality, of mitigation, remediation and prevention of violations, and of the due diligence procedures already in place. An important part of this assessment could be done by the reporting company itself, if it were mandatory to report under the CSRD sustainability reporting standards to criteria that are (to specifically this purpose) aligned with the MS requirements. This would be part of a company's broader assessment of its sustainability impacts, including the aspects of mitigation and remediation, prevention, etc. This assessment would then also be subject to external assurance, as required by the CSRD, and it would be publicly available to all stakeholders. It should then also transfer into the methodologies of data and rating providers, but this might warrant separate monitoring by the EU. We would like to point out, though, that also the harmonisation between the MS and the SFDR PAI requires further scrutiny, also in terms of current practices (e.g. controversy screenings) in the absence of the required data. Though the instruments of the Taxonomy and the SFDR serve different purposes due to their nature, they do overlap in sustainability topics and therefore the underlying methodologies and criteria should be as aligned as possible. See also our reply to question 5.2.

We are aware that this approach cannot be translated one-on-one to non-EU companies (not subject to the CSRD/CSDDD). However, this does not mean that the bar should be lowered regarding the proper assessment of EU companies. A sequential approach therefore seems unavoidable: once a clear framework has been developed within the EU legal context and the possibilities that it offers, an alternative (but qualitatively as similar as possible) approach for non-EU companies (not subject to CSRD/CSDDD) should be developed.

Question 3.2 Are there other types of external checks you would suggest (data for these checks should be publicly available and lead to the same result for a company)?

Yes; No; Don't know / no opinion / not applicable

Please specify and explain the other types of external checks you would suggest:

5000 character(s) maximum

Within the European Sustainable Finance framework, it makes sense to closely knit together the assessment of non-compliance with the MS (not only in terms of due diligence procedures, but also in terms of actual outcomes) with the CSRD reporting standards on the identification, tracking and remediation of principal actual or potential adverse sustainability impacts in the respective areas of the MS, both in the company's operations and in its value chain (as required by CSRD 19a/29a(2e sub i-iii)). This means that the reporting standards should specifically facilitate the assessment of non-compliance with the MS in terms of actual outcomes. In practice, this would require the development and earmarking of certain disclosures as indicators relevant to establishing non-compliance, according to a clear reporting framework to be used by reporting companies and subject to a materiality assessment. Following the CSRD assurance requirement, such disclosures would also be subject to external assurance. Once established, a qualitatively similar approach to non-EU companies may perhaps be developed.

The advice given in the Report on corruption, taxation and fair competition is comparable to the advice on human rights in that it requires that a company has implemented processes to avoid and address negative impacts and that the company has not been finally convicted for violations in these fields.

Question 4. Do you agree with this approach?

Yes; No; Don't know / no opinion / not applicable

Please explain your answer to question 4:

5000 character(s) maximum

For questions 4-4.2, we refer to our answers under 3 for an explanation of the practical shortcomings we have identified in the PSF's draft advice and for the alternative solutions we propose, which are equally valid for human right related MS as for governance-related MS. However, we would like to draw further attention to our suggestion to broaden the scope of governance criteria included in the assessment and the thus far limited alignment with the CSRD and SFDR in this area. We discuss this in more detail in our answer to question 6.2.

Question 4.1 Which type of court cases should be selected as criterion for non-compliance with minimum safeguards?

5000 character(s) maximum

We refer to our answer under 4.

Question 4.2 Are there other types of external checks you would suggest (data for these checks should be publicly available and lead to the same result for a company)?

Yes; No; Don't know / no opinion / not applicable

Please specify and explain the other types of external checks you would suggest:

5000 character(s) maximum

We refer to our answer under 4.

A suggestion given in the Report on MS is to consider the human rights due diligence processes companies have implemented and do checks on their performance, rather than rely on controversy checks based on media coverage (as is done by some ESG rating agencies).

Question 5.1 What do you think these changes imply for companies?

5000 character(s) maximum

Similarly to our response under question 3, what is currently produced as part of ‘controversy screenings’ (whether this is done by ESG rating agencies or else, or whether a screening outcome is used by a company or by investors is not relevant) should be fully covered by CSRD reporting on adverse sustainability impacts. It thus feeds into a broader assessment of actual outcomes and of MS compliance, as proposed above. We agree with the report that the absence of controversies does not necessarily equal MS compliance.

Question 5.2 What do you think these changes imply for investors?

5000 character(s) maximum

Similarly to our response under question 3, what is currently produced as part of ‘controversy screenings’ (whether this is done by ESG rating agencies or else, or whether a screening outcome is used by a company or by investors is not relevant) should be fully covered by CSRD reporting on actual sustainability impacts. It thus feeds into a broader assessment of actual outcomes and of MS compliance, as proposed above. We agree with the report that the absence of controversies does not necessarily equal MS compliance. However, investors currently do rely on controversy screenings as a proxy to determine violation of certain standards, for example to comply with their own SFDR PAI transparency requirements. We should be aware that any guidance regarding establishing non-compliance with the MS should be adequately aligned with the ability of investors to efficiently fulfil their obligations under the SFDR as well. This might be especially an issue in the short term (i.e. before the CSRD comes into full effect), when the required data will not yet be available.

The OECD guidelines for multinational enterprises highlight the importance of good corporate governance. The Report takes this up by developing criteria for bribery/corruption, taxation and fair competition.

Question 6. Do you agree with this approach?

Yes; No; Don't know / no opinion / not applicable

Question 6.1 Which other aspects of good corporate governance matters do you believe the advice should cover or refer to would you like to add?

5000 character(s) maximum

Good corporate governance is not limited to criteria regarding bribery/corruption, taxation and fair competition. The foundations of good corporate governance cover a broad spectrum of governance, risk management and internal control, as well as business conduct. The PSF advice includes aspects of business conduct (as found in ESRS G2), but does not explicitly cover the other factors. These other factors are currently partially covered by ESRS G1, but should preferably be extended to cover others as well, such as shareholder rights (e.g. deviations from the 'one share one vote' principle), separation between the functions of Chair and CEO, and a majority of independent non-executive directors.

As the PSF-report has also pointed out, the CSRD sustainability reporting standards exposure draft are currently not fully aligned with the requirements under the SFDR, in the sense that they do not require reporting on tax compliance by reporting companies. This will consequently also hinder the implementation of the suggested approach to assess the actual outcomes in this area, because tax compliance reporting would not be produced under the CSRD.

We have also noticed that the definition of 'corruption' in the exposure drafts of the ESRS also intends to cover 'fraud', which is not separately defined or treated as such. This bundling, we feel, is not practical, but it might need to be explicitly taken into consideration if the PSF framework to assess MS compliance regarding 'corruption' is designed to be fully inclusive of the concept of 'fraud' as well.

Question 7. Do you have further suggestions or comments on the Report?

5000 character(s) maximum

n/a

Additional information

Should you wish to provide additional information (e.g. a position paper, report) or raise specific points not covered by the questionnaire, you can upload your additional document(s) below.

n/a

End of questionnaire