PENSIONS EUROPE

PensionsEurope provides feedback on the EC proposal for a Corporate Sustainability Due Diligence Directive.

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General remarks

PensionsEurope welcomes the opportunity to comment on the proposal of the European Commission for a Corporate Sustainability Due Diligence Directive. PensionsEurope supports the objectives of the OECD Guidelines on Responsible Business Conduct, to which a large number of pension funds have already voluntarily committed. PensionsEurope is also supportive of creating equal obligations and frameworks across the EU through legislation, which ensures that companies live up to their responsibility to protect human rights and the environment. Moreover, we believe that the Directive could create a level playing field in the EU.

However, we see the need for clarifications in the proposed directive, and we would like to make the following observations.

Scope

First, PensionsEurope believes that the provisions on the scope of the due diligence are unclear regarding the activities of institutional investors. The proposal brings into the scope the entire financial sector irrespective of legal personality, including pension funds. The main activity of a pension fund concerning the proposal is investing contributions on behalf of employees in a diversified portfolio of assets: shares, corporate and government bonds, credits, real estate, infrastructure, and private equity. In most cases, pension funds will be minority shareholders with only a fraction of the shares. The question is whether these activities fall within the scope of the due diligence requirements of the CSDDD. Several definitions and provisions seem to indicate that this is not the case.

- The definition of “value chain” and “business relationship” mention that for financial services companies there needs to be a client relationship and finance needs to be provided to this client. The majority of investments are securities bought on the secondary market.
- Due diligence has to be exercised only ahead of the provision of the financial services. This provision seems tailored towards services such as banking and insurance. Pension funds trade on a continuous basis in order to rebalance the portfolio and invest contributions. It is unclear whether due diligence has to be exercised ahead of each trade or only when it was decided to include the investee company in the portfolio.

Nevertheless, we have understood that the European Commission believes that pension funds should conduct due diligence on investments, including shares and corporate bonds purchased on the secondary markets. If this is indeed the case, the proposal would merit various clarifications. Otherwise, it would create unclarity amongst pension funds and supervisors about the scope of the requirements.

Moreover, it is also necessary to clarify what is understood under “own operations”. Pension funds will also need to conduct due diligence down the value chain of their own operations, next to their investments.

Finally, should also be explicitly clarified that where the service provider does not have discretionary power to deny service, e.g., when collective bargaining agreements make occupational pensions mandatory for employers and providers, due diligence requirements and obligations to deny or terminate service should not apply.

Alignment with OECD guidelines

The proposal diverges from the OECD guidelines in a number of meaningful ways, particularly considering the guidance the OECD has published on how the guidelines should apply to institutional investors. This divergence from the OECD framework is not in line with the practice of institutional investment. The OECD guidelines establish different levels of involvement in an adverse impact ("linked to", "contribute to" and "cause"), which seems to be missing from the CSDDD proposal. Moreover, the OECD recommendations for institutional investors acknowledge the different roles an institutional investor can play compared to a company.

These recommendations state that minority shareholding can be seen as linking investors to adverse impacts through a business relationship with the investee company. The investor can be held accountable for using its leverage as a shareholder through engagement and potentially divestment. However, the investor cannot be held responsible for addressing the adverse impact. This is particularly problematic for the CSDDD provisions on bringing adverse impacts to an end (including compensation) and civil liability. Moreover, the main tools for companies to avoid adverse impacts – contractual clauses and codes of conduct – are not realistic tools for institutional investors. Pension funds do not have a contractual relationship with investee companies and therefore cannot force onto investee companies their codes of conduct or contractual clauses. Moreover, a pension fund typically invests in thousands of companies, so it would be very cumbersome to follow-up with all of these companies. EU investee companies will be subject to the CSDDD themselves, which will be helpful, but a significant part of the portfolio is invested in non-EU companies. Therefore, due diligence will be an extremely challenging exercise for pension funds, a huge administrative burden, extremely costly and time consuming especially when it has to be executed globally.

In addition, shareholder engagement, which is a crucial role in the OECD guidelines and is one of the main ways for institutional investors to address adverse impacts, is playing a limited role in the CSDDD proposal. This could imply that divesting is the main option in order to avoid adverse impacts under the proposal, while it is broadly accepted that stewardship is one of the main ways for the financial sector to contribute to positive sustainability outcomes.

Directors' duties and liability

The proposal imposes serious consequences when companies fail to fulfil their due diligence obligations. This failure may lead to civil liability, as well as a breach of directors' duty of care. Given the scope of due diligence is unclear, it is currently difficult to assess *a priori* whether a pension fund has met the obligations of the proposal or whether the pension funds and/or its directors are in breach. Moreover, if shareholders were to face liability for companies they invest in, this would undermine the principle of limited liability. Moreover, damages paid by investee companies would lead to reduced returns, so pension funds have a strong motivation to avoid adverse impacts on the portfolio even without direct liability.

Reporting

In recent years, the European Commission has adopted comprehensive new regulations in the field of sustainability, including the sustainability taxonomy (EU 2020/852 with subsequent delegated acts), the Sustainable Finance Disclosure Regulation and the CSRD. PensionsEurope believes that the proposal for the due diligence directive has not been sufficiently harmonized with already existing regulations in the area and planned regulations. Companies will have to operate according to different definitions of human rights and environmental protection, depending on whether in a specific situation they focus on the due diligence directive or the Taxonomy regulation. Moreover, the reporting that companies must provide following article 11 of the Due Diligence Directive will be based on other KPIs than the reporting that companies have to provide according to Article 8 of the Taxonomy Regulation, which will make it difficult to compare.

Miscellaneous

Furthermore, according to article 15, companies, under the relevant thresholds and sectors, must adopt a plan for transition to meeting the objectives of the Paris Agreement. PensionsEurope believes that more clarity is needed on the plan's form.

Finally, Articles 17 to 21 of the proposed directive provide a framework for monitoring compliance with the provisions of the directive. In this connection, PensionsEurope notes that the EU's other sustainability regulations (CSRD, Taxonomy Regulation and SFDR) also contain rules and frameworks for supervision by the National Competent Authorities. At the European level, the supervision of sustainability regulation is coordinated by the pan-European supervisory authorities, respectively EBA, ESMA and EIOPA. PensionsEurope strongly encourages the supervision of compliance with sustainability regulation within the already established framework - both at the national and EU level and thus, new supervisory authorities or structures should not be introduced. The establishment of a new supervisory authority will create unclear boundaries between different supervision authorities and contribute to uncertainty regarding how specific matters are regulated. Such a situation would entail unnecessary administrative burden and expense for the IORPs concerned.

About PensionsEurope

PensionsEurope represents national associations of pension funds and similar institutions for workplace and other funded pensions. Some members operate purely individual pension schemes.
PensionsEurope has **25 member associations** in 18 EU Member States and 4 other European countries[1].

PensionsEurope member organisations cover different types of workplace pensions for over **110 million people.** Through its Member Associations PensionsEurope represents **€ 7 trillion of assets** managed for future pension payments. In addition, many members of PensionsEurope also cover personal pensions, which are connected with an employment relation.

[1] EU Member States: Austria, Belgium, Bulgaria, Croatia, Denmark, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Luxembourg, Netherlands, Portugal, Romania, Spain, Sweden. Non-EU Member States: Iceland, Norway, Switzerland, UK.

PensionsEurope also has **19 Corporate and Supporter Members** which are various service providers and stakeholders that work with IORPs.

PensionsEurope has established a **Central & Eastern European Countries Forum (CEEC Forum)** to discuss issues common to pension systems in that region.

PensionsEurope has established a **Multinational Advisory Group (MAG)** which delivers advice on pension issues to PensionsEurope. It provides a collective voice and information sharing for the expertise and opinions of multinationals.

What PensionsEurope stands for

- A regulatory environment encouraging workplace pension membership;
- Ensure that more and more Europeans can benefit from an adequate income in retirement;
- Policies which will enable sufficient contributions and good returns.

Our members offer

- Economies of scale in governance, administration and asset management;
- Risk pooling and often intergenerational risk-sharing;
- Often "not-for-profit" and some/all of the costs are borne by the employer;
- Members of workplace pension schemes often benefit from a contribution paid by the employer;
- Wide-scale coverage due to mandatory participation, sector-wide participation based on collective agreements and soft-compulsion elements such as auto-enrolment;
- Good governance and alignment of interest due to participation of the main stakeholders.

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