

# Corporate Sustainability Due Diligence Directive (CSDDD) – Final Restated DUFAS Position

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From Dutch Fund and Asset Management Association (DUFAS)  
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## Executive summary

The Dutch Fund and Asset Management Association (DUFAS) supports the European Commission proposal for a Corporate Sustainability Due Diligence (CSDDD) Directive published on 23 February 2022. We welcome that CSDDD places human rights and environmental due diligence requirements on large firms catered to the direct and indirect contractual business relationships.

- *What do we support exactly in connection with asset managers?* DUFAS supports the application of CSDDD to asset managers, provided of course they fall within the threshold of CSDDD. However, due diligence requirements under CSDDD should only relate to (i) due diligence on the own operations like any other large undertaking, (ii) the supply chain and (iii) their clients to whom asset managers offer investment advice or individual portfolio management services (mandates), **excluding** the value chain as such clients.
- *What do we not support?* DUFAS does not support extending the CSDDD due diligence to investee companies. In other words, we do believe that CSDDD due diligence requirements, and the attached civil liability proposed under CSDDD, should **not** apply to each and any investment an asset manager makes in the execution of the investment policy of an investment fund, - UCITS or AIF-, or in connection with investment services such as the management of an individual client portfolio or investment advice rendered by an investment firm under the MiFID regime or by an UCITS or AIF investment management company. In other words, we do not support extension of CSDDD due diligence requirements for asset managers to investee companies for a number of reasons explained further in this position paper. For the avoidance of a doubt, a specific carve out should therefore be made for investment funds – UCITS and AIFs-, and for due diligence on investee companies in connection with investment services as defined in MiFID rendered by asset managers to their clients.
- *Potential impact?* The ultimate consequence of a too stringent due diligence regime under CSDDD, also because of the potential civil liabilities attached, may force asset managers to refrain from certain investments, but also could lead to divestments as a result of such legal requirements. This may have a major impact on potential of investments to support the transition to a sustainable economy and may even exclude for example investments in certain emerging markets for that matter.

## DUFAS does not support extending CSDDD due diligence to investee companies

### Impact:

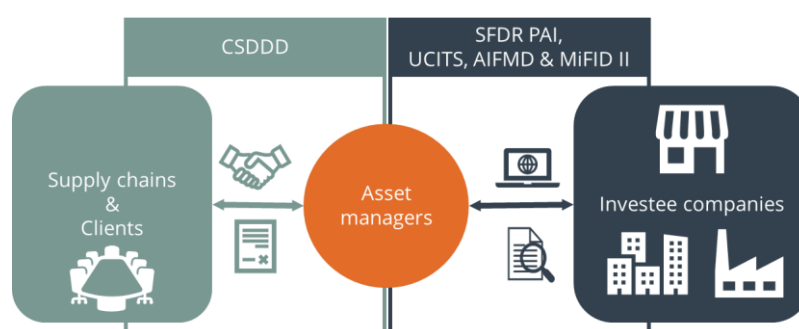
1. If extended to investments, the extent of the CSDDD due diligence requirements and the potential liabilities attached, may have the undesirable effect that it discourages and may potentially forbid investments in for example emerging and other markets crucial for the transition to a sustainable economy. This is caused by civil liability imposed under CSDDD which is unsuitable for investor and investee relationships.
2. CSDDD due diligence is hard or even impossible to implement for widespread strategies such as index investing and investments in infrastructure and alternative markets. It may have detrimental effects on index investing.
3. Extending CSDDD stringent due diligence to investments increases costs for investors without clear benefits.

### Due diligence is already in place:

1. Asset managers already perform extensive ESG due diligence on investments.
2. There is no need to impose ESG due diligence on asset managers as this is already regulated under SFDR, UCITS, AIFMD and MiFID, without the potential liability and sanctions regime.

## DUFAS is in favour of the CSDDD proposal but does not support extending CSDDD due diligence to investee companies

As said DUFAS supports the European Commission proposal for the CSDDD. However, the scope of included financial services for asset managers is not clear. The proposal does not specify whether and which types of investments are included as financial services, although we presume that by financial services offered by asset managers, this meant to be investment services, such as investment advice and individual portfolio management under MiFID. The current text also defines the value chain of financial services by regulated financial undertakings to clients. The meaning of clients differs widely within the financial sector, and for asset managers this may suggest referring to investors as well, apart from being a client under an individual portfolio management or investment advisory agreement. DUFAS welcomes CSDDD due diligence on the own operations, supply chain and clients, with the exclusion of their value chain, of asset managers as this is not covered by current regulations. However, we do not support extending the CSDDD due diligence catered to supply chain relations to the investor-investee company relationship.



**Figure 1. CSDDD covers clients, own operations and supply chains of asset managers and complements SFDR PAI, UCITS and AIFMD covering investees**

Furthermore, the current proposal requires further defining key concepts. For example, it is currently unclear which services by asset managers are included as 'other financial services' and with which clients there is a relevant 'business relationship' to be included in the value chain. Also, excluding natural persons from value chains is mentioned in recital 19 but not explicitly stated in article 3(g) defining the value chain. Unambiguous definitions are needed to operationalize the internal, supply chain and client due diligence processes as well

as to avoid further specifications by the European Commission on key terminology during the implementation phase as is currently happening for SFDR, e.g., the practical interpretation of sustainable investments.

**If extended to investments, CSDDD discourages and potentially forbids investments in emerging markets and others that are crucial for the transition to a sustainable economy**

The CSDDD due diligence may have undesirable side-effects if extended to investments and investee companies. The consequence of a too stringent due diligence regime as envisaged by CSDDD may force asset managers to refrain from certain investments, but also could lead to divestments as a result of such legal requirements. This may have a major impact on potential of investments to support the transition to a sustainable economy. Investments provide leverage to asset owners, via asset managers, to engage companies through active shareholder dialogues and voting rights. CSDDD could require or at least encourage asset managers to divest and avoid emerging market companies and initiatives, as governance standards on human rights and environmental impacts may not meet European standards. Should investing in such companies provide legal uncertainty with potential civil liabilities and sanctions, engagement and capital will be impeded as powerful instruments to drive companies to improve sustainability where needed the most.

**Asset managers already perform extensive ESG due diligence on investments**

In Europe, ESG due diligence, investor code of conduct, and engaging investee companies are standard practices in the market. The funds and portfolios range widely in the number of included investees from being concentrated with a few dozen to being broad and diversified with hundreds or thousands investee firms.

ESG due diligence practices are shaped by the characteristics of the fund or the mandate set by the institutional client. In depth due diligence on all investees is feasible for concentrated funds, whereas broad diversified funds rely on a risk-based approach and data provided by specialized data vendors, e.g., violation of human rights, to determine which companies to engage or exclude. Additionally, asset managers frequently hire external asset managers for specific portions of the fund or portfolio such as venture capital and infrastructure investments. Due diligence on external asset managers, including on ESG, is also standard market practice. The current practices show that European investors and asset managers are at the forefront of integrating ESG and sustainability into investing.

**ESG due diligence for investments is already regulated under SFDR, UCITS and AIFMD**

The CSDDD proposal places due diligence requirements that are catered to contractual ties, whether direct or indirect, within supply chains. These requirements are unsuitable for the investor-investee relationship and overlap incoherently with the EU Sustainable Finance framework which has already introduced regulations that specifically address due diligence practices. The Sustainable Finance Disclosure Regulation (SFDR), in force since March 2021, includes due diligence on principal adverse impact (PAI). Asset managers with more than 500 FTE, one of the CSDDD thresholds, must measure and manage these PAIs. This requires annually measuring each impact, performing actions to manage each impact, and planning actions and setting targets for the next year. Overlap with the Sustainable Finance framework should be avoided where possible. For example, in the Corporate Sustainability Reporting Directive (CSRD) overlap with SFDR is being avoided by exempting financial products such as AIFs and UCITS from the scope. In a similar way, it seems logical that funds and investee companies should not be in scope of CSDDD.

Furthermore, the core legislations governing investment funds and asset management, UCITS (1 Aug 2022), AIFMD (1 Aug 2022) and MiFID (2 Aug & 1 Nov 2022), were recently amended to integrate sustainability into funds. Among the changes was the inclusion of due diligence on PAIs, explicitly linked to SFDR. These recent developments show that ESG due diligence in the investment chain is already covered by common practice and the regulations at the core of asset management.

**Extending CSDDD due diligence to investments increases costs for investors without clear benefits**

Asset managers have recently implemented systems to improve due diligence in line with SFDR PAI, UCITS and AIFMD. For this due diligence investors rely, and are expected to rely, on public information and data

vendors rather than internal investee data. CSDDD requires identifying and addressing actual and potential adverse human rights and environmental impacts before each investment. This creates a disproportionate burden given that asset managers trade many investments in a day, particularly when it comes to taking action in connection to prevention and mitigation adverse impacts. For many funds and portfolios this would also require an overhaul of the implemented due diligence system which requires significant time and resources. Furthermore, broad diversified funds with hundreds or thousands of investee companies would require a much larger workforce to conduct due diligence than the capacity of current investment teams compared to the current risk-based approach. Thus, CSDDD would lead to increased costs, therefore negatively affecting net returns of retail investors, pension funds and other investors, without clear benefits compared to existing ESG due diligence practices.

### **CSDDD due diligence could invalidate widespread strategies such as index investing and investments in infrastructure and alternative markets**

Funds and mandates can follow active and passive styles. Active investing requires asset managers to analyse and pick specific investments such as stock and bonds. In contrast, passive investors follow the portfolio set by a benchmark with rules determining the included investments. The latter is a common strategy providing retail and institutional investors with low cost and diversified portfolios. The CSDDD due diligence requires assessing each individual investment which undermines the benefits of passive index investing. The lack of a risk-based approach may also discourage asset managers from investing in infrastructure and alternative markets, which are crucial for to transition to a sustainable economy, as governance standards on human rights and environmental impacts may not meet European standards.

### **Civil liability under CSDDD is unsuitable for investor and investee relationships**

The level of leverage that investors have over investee companies varies significantly depending on the level of their ownership stake or shareholders' rights. In particular as minority shareholders it is not possible to impose a code of conduct or prevention plans on investee companies; the investors are limited to their existing tools, namely engagement and voting rights in shareholder meetings, and cannot assume the role of the board. Therefore, asset managers as minority shareholders should not be held responsible for remediation or face liability for adverse impacts caused by investee companies given these constraints:

1. There are no direct operational or contractual ties between investors and listed investees which makes it more difficult to undertake actions in connection to adverse impacts
2. Minority shareholders represent the largest proportion of asset under management.
3. References guidelines for implementing ESG due diligence practices do not provide sufficiently concrete guidance for asset managers as minority shareholders.
4. Imposing liability on shareholder or the board of directors for failure to perform the due diligence requirements under CSDDD is incompatible with existing national company laws.

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### **DUFAS: Dutch Fund and Asset Management Association**

Since 2003, DUFAS has been committed to a healthy asset management sector in the Netherlands. DUFAS has more than 50 members: from large asset managers who invest Dutch pension and insurance assets to smaller, specialist asset managers. DUFAS increases awareness of the social relevance of investing, helps to develop sector standards and represents the sector in the implementation of new laws and regulations. In addition, DUFAS is committed to a single European market with equal regulations.

### **More information**

Would you like to respond, or should you have any questions? We would be pleased to hear from you. Please feel welcome to e-mail Randy Pattiselanno, DUFAS manager strategy & regulatory affairs, [rp@dufas.nl](mailto:rp@dufas.nl).