

# Why the financial sector must be included in the EU Directive on Corporate Sustainability Due Diligence (CSDDD)

**fidh**

Financial institutions (FIs) are key actors in driving the economy and thus play a significant role in ensuring the corporate respect for human rights and the environment.<sup>1</sup> The [UN Guiding Principles on Business and Human Rights \(UNGPs\)](#) and the [OECD Guidelines for Multinational Enterprises on Responsible Business Conduct \(OECD GL\)](#) have clarified the applicability of due diligence frameworks to the financial sector.<sup>2</sup> Financial institutions have also increasingly made efforts to integrate human rights and environmental safeguards into their own policies to align with existing standards of responsible business conduct<sup>3</sup> and better engage stakeholders.<sup>4</sup>

As part of the current negotiations on the [EU Directive on Corporate Sustainability Due Diligence \(CSDDD\)](#), a great uncertainty remains as to whether the financial sector will be included and subjected to the upcoming due diligence obligations. In fact, excluding FIs would run counter already established practices and undermine the sector's efforts to act more responsibly. Since FIs are able to contribute to human rights violations like any other sectors, they should be subjected to the same due diligence obligations. FIs also have access to significant levers which they can use to exert influence on companies operating within their sector. Since using these levers constitute an essential element of the due diligence process, renouncing them would significantly shrink the potential of the legislation.

# 1. Financial institutions need mandatory due diligence obligations

There is no doubt that financial institutions can directly or indirectly contribute to serious violations of human rights and the environment. The following cases underline the importance of moving away from voluntary responsible business conduct to establish mandatory due diligence obligations for the sector.

## 1.1 French banks and pension fund supporting Myanmar military junta

Five major **French banks** - the Crédit Agricole, La Banque Postale, the BPCE group, BNP Paribas, Société Générale - and a **pension fund** the Fonds de Réserve pour les Retraites (FRR) are still investing in companies which have a direct business relationship with the Myanmar military junta, as revealed by Info Birmanie, BankTrack, and [Justice for Myanmar's report](#). The junta, which seized power in 2021, has since been accused of committing [war crimes and crimes against humanity](#) in the country. Yet, as of March 2023, the shares held by these six FIs in the businesses linked to the junta amounted to more than US\$ 6 billion.<sup>5</sup> Voluntary frameworks have thus proven their ineffectiveness. Given the dramatic evolution of human rights violations in Myanmar since 2021, FIs should be clearly required to conduct ongoing human rights impact assessments of their operations, to use their levers, and put an end to any support contributing, allowing, or facilitating rights violations.

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1. OHCHR "Financial sector. OHCHR and business and human rights" (online). [Accessed on August 25, 2023]. Available at: <https://www.ohchr.org/en/business-and-human-rights/financial-sector>

2. See [OHCHR Guidance](#) for the application of UNGPs to the financial sector. See also [OECD Responsible business conduct in the financial sector](#).

3. Some financial institutions have integrated, among others, the social and environmental safeguards and sustainability standards from the **Common Approaches, EPs, and IFC Performance Standards** into their policies and practices. See OECD (2022), Responsible Business Conduct Due Diligence for Project and Asset Finance Transactions, OECD Business and Finance Policy Papers, OECD Publishing, Paris, p.10. <https://doi.org/10.1787/952805e9-en>.

4. OECD (2022), Responsible Business Conduct Due Diligence for Project and Asset Finance Transactions, OECD Business and Finance Policy Papers, OECD Publishing, Paris, p. 17. <https://doi.org/10.1787/952805e9-en>.

5. FIDH (2023). "New report names five French banks and a pension fund supporting Myanmar military junta" (online). Available at: <https://www.fidh.org/en/region/asia/myanmar/new-report-names-five-french-banks-and-a-pension-fund-supporting>.

## 1.2 Financial flows in illegal Israeli settlements

Between January 2019 and August 2022, **725 European FIs** including banks, asset managers, insurance companies and pension funds had financial relationships with **50 business companies** actively engaged in the Israeli settlement enterprise in the Occupied Palestinian Territory (OPT).<sup>6</sup> As demonstrated by the [report](#) from the “**Don’t Buy Into Occupation**” (DBIO) coalition, of which FIDH is part, nearly **US\$ 300 billion** was provided to these companies in the form of loans, underwritings, and holding of shares and bonds. Illegal under international law, Israeli settlements “constitute acts which incur individual criminal liability as **war crimes and crimes against humanity** under the Rome Statute of the International Criminal Court (Rome Statute)”.<sup>7</sup> FIs - just like any other business - have a responsibility to conduct human rights and environmental due diligence (HREDD) on their **own operations** and those of their **business relationships**.<sup>8</sup> They should also exercise **leverage** on their partners to ensure they put an end to any violation or to **finally divest** from them when they are unable or unwilling to end such violation.<sup>9</sup> Although several FIs, including Kommunal Landspensjonskasse (KLP), Storebrand and the Norwegian Government Pension Fund Global (GPF) have since divested from settlement-related businesses,<sup>10</sup> voluntary standards have proven insufficient to convince other FIs still involved. It is thus crucial that the new directive targets and foresees obligations for FIS.

## 2. Gaps to address in the Directive

In the current CSDDD draft, the [Commission](#), [Council](#) and [Parliament](#) all exempt FIs from certain due diligence obligations compared to other business sectors. In order for a mHREDD directive to be truly effective, drafters should rectify the key gaps contained in the project and identified as followed:

### Definitions and Scope: Article 3(a)(iv) and 3(g)

- The Council leaves it up to Member States to decide **whether or not the Directive applies** to the financial sector (Recital 19, Art. 2(8)). This is highly problematic as it is not driven by human rights considerations and would prevent the implementation of a legal level-playing field among EU countries. It would also create distortions among companies that are not subjected to due diligence obligations according to their sector and without any substantial justification that would be based on an assessment of the risk of involvement and contribution to violations by the company.
- All three institutions **exclude small and medium-sized undertakings** and refuse to explicitly consider the financial sector as **a high-impact sector**, contrary to OECD Guidance (Recital 22). Lastly, both the Council and Parliament reject some **financial products** introduced by the Commission,<sup>11</sup> which considerably reduces the scope of applicability of the directive.

6. FIDH (2022). “Don’t Buy Into Occupation: French financial institutions linked to Israeli colonisation in Palestine” (online). Available at: <https://www.fidh.org/en/issues/international-justice/dont-buy-into-occupation-french-financial-institutions-linked-to>

7. Don’t Buy Into Occupation (2022). “Exposing the financial flows into illegal Israeli settlements” report. Published on 05 December 2022. Available at: <https://dontbuyintooccupation.org/reports/dont-buy-into-occupation-report/>

8. OECD GL II.11 (General policies); OECD GL IV.5 (Human Rights)

9. OECD (2022), Responsible Business Conduct Due Diligence for Project and Asset Finance Transactions, OECD Business and Finance Policy Papers, OECD Publishing, Paris, p. 47 <https://doi.org/10.1787/952805e9-en>

10. FIDH (2022). “Don’t Buy Into Occupation: French financial institutions linked to Israeli colonisation in Palestine” <https://www.fidh.org/en/issues/international-justice/dont-buy-into-occupation-french-financial-institutions-linked-to>

11. Council and Parliament removed “pension institutions operating pension schemes which are considered to be social security schemes covered by Regulation (EC) No 883/2004 of the European Parliament and of the Council<sup>1</sup> and Regulation (EC) No 987/2009 of the European Parliament and of the Council<sup>2</sup> as well as any legal entity set up for the purpose of investment of such schemes”, “an alternative investment fund (AIF) managed by an AIFM as defined in Article 4(1), point (b), of Directive 2011/61/EU or an AIF supervised under the applicable national law”, and “UCITS in the meaning of Article 1(2) of Directive 2009/65/EC” (Art. 3(a)(iv))

### Identification of adverse impacts: Article 6(3)

- FIs are merely required by the Commission and Council to identify adverse impacts since the contract's inception and **before** providing a service. Council further specifies that FIs "should **not be** required to assess the adverse impacts in a dynamic way or at regular intervals" (Recital 30). This approach undermines UNGP 17c and OECD GL 45 which underline the **ongoing** nature of the HREDD process and impact assessments.
- While Parliament rightfully adds the obligation for FIs to identify adverse impacts "**before** subsequent financial operations" and "**during** the provision of the service" if notified of possible risks under the procedures in article 9 (Recital 30), such obligations should also be applied **after** the provision of financial services given the existence of adverse impacts downstream the value chain.

### Prevention of adverse impacts: Article 7(1b)

- Parliament explicitly adds the presumption that FIs are only "directly linked to an adverse impact in their value chain without causing or contributing to it". This presumption is problematic as FIs may also **cause or contribute** to an adverse impact. Assuming they can **only be directly linked** to an impact risks narrowing down their due diligence obligations and creating new barriers to liability for victims of abuse.

### Temporary suspension or Termination of a business contract: Articles 7(6) and 8(7)

- All three institutions allow FIs to **derogate** from their obligation under articles 7(5) and 8(6) to temporarily suspend or terminate a business relationship when the adverse impact of disengaging is severe. Commission and Council justify this derogation by the "reasonable expectation" that termination would cause "**substantial prejudice**" to the business enterprise or result in a more severe impact. In turn, Parliament conditions it to the strict necessity to prevent the **bankruptcy** of the business. The threat of divestment is the more important leverage that FIs have over their clients. They should thus be given the opportunity to divest from business relationships when mitigating or ceasing the harm has failed or is not possible. Thus, one should not question the potential, which was proven in practice, of a temporary suspension or termination as the only way to put an end to a violation or to its contribution.

## 3. Recommendations

Thus, the Directive proposal shall:

- Require FIs to carry out HREDD - including human rights and environmental impact assessments - across their **entire** value chain, **continuously**, and at **each stage** of the due diligence process;<sup>12</sup>
- Be applicable to **all** financial services and products, including pension institutions, AIFs and UCITS;
- Remove the presumption that FIs are directly linked to adverse impacts to **avoid downplaying** their responsibility in causing or contributing to adverse impacts;
- Recognise it may be necessary and provide the opportunity for FIs to **divest from business relationships** after mitigation or cessation of adverse impacts by the business enterprise has failed or is not possible.

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12. FIDH, "Europe can do better. How EU policy makers can strengthen the Corporate sustainability due diligence directive" June 2022, p. 5.





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**Design:**

FIDH/Noam

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