

GAM EXPLAINS: CSDDD

CSDDD – EUROPE'S CHANGING ESG REGULATORY LANDSCAPE

What is it?

Why it matters to investors

Three top takeaways

What to look out for

Governments, businesses and civil society have increasingly called for mandatory sustainability legislation, resulting in significant regulatory developments taking place across the EU, US and beyond.

With an overwhelming array of frameworks, largely reduced to acronyms such as [SFDR](#) (Sustainable Finance Disclosure Regulation), [GRI](#) (Global Reporting Initiative), [ISSB](#) (International Sustainability Standards Board) and [EFRAG](#) (European Financial Reporting Advisory Group), popping up all over the world, the sustainability regulatory world can be a difficult one to navigate. In this explainer, we focus on the Corporate Sustainability Due Diligence Directive ([CSDDD](#)) which is set to have game-changing consequences for the corporate landscape in Europe. It is also geared up to operate in tandem with the Corporate Sustainability Reporting Directive ([CSRD](#)).

Europe is committed to ambitious climate targets through the [European Green Deal](#), especially becoming net zero [by 2050](#). This is on top of targets from the [EU's human rights strategy](#) and the UN's Sustainable Development Goals ([SDGs](#)) which set out targets for advancing a host of areas from gender equality to affordable energy. Businesses play a key role in society's ability to tackle environmental and social issues, yet the increasingly interconnected and intricate nature of global supply chains can make it challenging to decipher where the impacts lie and therefore action is required. Fragmented national rules can complicate this further, with differing application of rules across different actors of the economy. To solve these challenges, Europe is in the process of enforcing sector-wide legislation that will affect how companies in Europe and elsewhere report and manage sustainability issues.

WHAT IS IT?

The CSDDD is seen as a landmark for legislating human rights and environmental due diligence as the responsibility of businesses. It aims to prevent and mitigate potential adverse impacts and bring actual adverse impacts to an end across the value chain. Member states are obliged to implement “effective, proportionate, and dissuasive” penalties for non-compliance, including maximum fines not less than 5% of the company’s net worldwide turnover.

The **CSDDD** will require ‘in scope’ companies to:

1. Fulfil human rights and environmental due diligence obligations, including identifying and assessing adverse impacts;
2. Prevent, mitigate and bring to an end / minimise such adverse impacts; and
3. Adopt and put into effect a climate change mitigation transition plan, which aims to ensure – through best efforts – compatibility of the company’s business model and strategy with limiting global warming to 1.5 °C in line with the Paris Agreement.

Companies must develop due diligence procedures (policies and risk-management systems), provide remediation, meaningfully engage with stakeholders and establish a complaints procedure. Periodic assessments to monitor and assess effectiveness are also required. Obligations apply throughout a company’s ‘chain of activities’ which includes both upstream and downstream business partners.

Dependent on the size of the company, there will be a period of three to five years from the Directive entering into force for companies to prepare for implementation.

WHY IT MATTERS TO INVESTORS

Global challenges such as climate change and nature loss are increasingly shaping the investment landscape and propelling the EU and other jurisdictions to introduce policy measure to support and accelerate the transition into a more sustainable economy. Inadequate corporate disclosure regarding sustainability-related risks, opportunities and impacts is frequently cited as a key barrier to better investment decision-making and efficient capital allocation. This regulation goes beyond the disclosure requirements outlined in the Corporate Sustainability Reporting Directive (CSRD) to require action from large companies to address environmental and human rights impacts.

While the number of companies that come into scope of CSDD has significantly reduced from the original proposal, the CSDDD applies to both EU companies and non-EU companies with significant EU operations. This includes EU companies with more than 1,000 employees and global turnover of more than EUR 450 million, and non-EU companies generating net turnover of more than EUR 450 million within the EU. The requirements create a more robust set of obligations alongside the disclosure requirements set out in the CSRD.

Obligations under CSDDD for financial sector companies are more limited, focusing only on the upstream supply chain of regulated financial institutions. However, this additional corporate disclosure – in particular requirements relating to **climate transition plans** – will be key enablers for investors meeting their own climate-related disclosure obligations and climate transition plans and targets, in addition to supporting consideration of principal adverse impacts as outlined under **SFDR**. In addition, the obligations impose a much higher cost of failing to appropriately manage environmental and human rights impacts.

THREE TOP TAKEAWAYS

1 – CSDDD introduces a fundamental shift

The CSDDD represents a monumental step in mandating not just disclosure but specific action in relation to actual and potential adverse environmental and human rights impact. The directive will also create company liability for damages caused by a company breaching its due diligence obligations and a requirement to fully compensate victims.

2 – Backlash on scope of due diligence directive

The original scope, when the European Commission first introduced its CSDDD proposal in 2022, was expected to bring approximately 50,000 companies into scope, similar in scope to the CSRD.

Just a few weeks before the EU Council approved the legislation on 15 March 2024, its future hung in the balance. After 45 days of closed-door negotiations, false starts and political pressure, a number of key member states signalled their intention to abstain, in part due to the 'potential administrative burden' of the directive. The subsequent change in scope means that now CSDDD is expected to apply to around 5,500 companies. While agreement was ultimately reached, this backlash to the original scope may signal a more targeted approach for future regulation.

3 – Effects will be felt beyond Europe

The impact of these new regulatory developments will not just be felt in Europe, as both non-EU businesses, and global supply chains will be impacted by this regulation.

The CSDDD is the latest piece of legislation in a broader move to introduce minimum sustainability standards for a range of products. Examples include the [EU deforestation regulation](#), promoting 'deforestation-free' products, namely those linked to the production of commodities such as cattle, wood, cocoa, soy, palm oil, coffee, rubber, and some of their derived products, such as leather, chocolate, tyres, and furniture, and the prohibition of the sale, import, or export of products made using [forced labour](#). These regulations will impact the conditions of trade with and within the EU single market for numerous sectors.

What is GAM Investments doing?

In 2023, we published our [human rights policy](#), committing to adopting responsible business practices consistent with the UN Guiding Principles that promote respect for human rights, including the rights enshrined in the Universal Declaration of Human Rights and eight Core International Labour Organisation (ILO) Conventions.

We are committed to ensuring that our supply chains are free of any slavery, human trafficking or child labour, and will not knowingly support or do business with any supplier who is involved in such activities. Appropriate due diligence is conducted as part of our procurement process to assess the extent of exposure to the risk of human rights violations.

WHAT TO LOOK OUT FOR

The Directive was finally approved by the European Parliament on 24 April 2024. Member states now have two years to transpose the Directive into national law. This includes publishing additional guidance regarding the due diligence obligations of 'in scope' companies, and nominating an appropriate supervisory authority to investigate and impose fines of up to 5% of the companies' net worldwide turnover.

The staged timetable will require companies with over 5,000 employees and worldwide turnover of over EUR 1.5 billion to comply from 2027, firms with over 3,000 employees and EUR 900 million worldwide turnover to comply from 2028, and the remaining in scope companies to comply from 2029.

CSDDD is designed to complement other existing and upcoming legislation, such as the [deforestation regulation](#), [conflict minerals regulation](#) and [regulation prohibiting products made with forced labour](#). Given the far-reaching implications, companies are advised to start preparations promptly. The work of implementing these new requirements, and the shift from disclosure to action, is only just beginning – for both companies and their investors.

For more insights from GAM, go to 'Our Thinking' [here](#).

To read our explainer on SFDR, another important piece of EU regulation aimed at preventing greenwashing, see [here](#).

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For more information, please visit [GAM.com](#)

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