



Corporate
Sustainability Due
Diligence Directive
adopted

24 April 2024

Executive summary

On 24 April 2024, the European Parliament adopted the final text of the Corporate Sustainability Due Diligence Directive (CS3D). This new legislation (“Directive”) outlines the requirements for businesses to implement due diligence measures across their global chain of activities and own operations to prevent, mitigate, and remedy adverse impacts on human rights and the environment.

The CS3D will be published in the EU Official Journal by autumn and will enter into force on the 20th day following its publication. Member States will then have a two-year period to transpose it to national law.

This following note outlines the key elements of the agreed text and provides an overview of the compliance obligations for businesses. Although the Directive provides a level-playing field and has a harmonizing effect across the EU, certain aspects will be defined by national legislation.

An increasing number of companies are using due diligence to identify risks for adverse impacts on people and the environment and build resilience. However, voluntary action has not resulted in large-scale improvements, resulting in persistent negative externalities from production and consumption, such as child labor, forced labor, greenhouse gas emissions and deforestation.

In recent years, several actors in the EU have called for new regulations to advance the green transition and protect human rights within the EU and beyond. In line with the European Green Deal, on 23 February 2022, the European Commission adopted a proposal for a Directive on Corporate Sustainability Due Diligence. The new rules aim to foster sustainable and responsible corporate behavior throughout global value chains, and to establish a harmonized legal framework in the EU, creating a level playing field for businesses.

Key takeaways

To whom does it apply?

- ▶ The CS3D establishes rules regarding companies' obligations to address actual and potential adverse human right impacts as well as adverse environmental impacts arising from **their own operations** or **those of their subsidiaries** and, where related to their chains of activities, **those of their business partners**.
- ▶ In terms of scope, the due diligence rules will apply to:
 - ▶ **EU companies (or ultimate parent companies)** that had more than 1,000 employees on average and a net worldwide turnover of more than €450 million in the last financial year.
 - ▶ **Non-EU companies (or ultimate parent companies)** that generated a net turnover of more than €450 million in the EU in the last financial year. The employee threshold does not apply to non-EU companies.

What about the financial sector?

- ▶ Financial services are only subject to due diligence obligations for the upstream part of their chain. It should not include downstream business partners that are receiving their services and products.
- ▶ It is noted in the text that regulated financial undertakings are expected to consider adverse impacts and to use their so-called "leverage" to influence companies. One way could be through the exercise of shareholders' rights.
- ▶ The Directive defines a review clause that will require the European Commission to submit a report on the need for additional due diligence requirements tailored to the financial sector.
- ▶ Financial sector companies are subject to the obligation of adopting and implementing a climate transitional plan for climate change in line with the Paris Agreement.

What are the key obligations for companies?

Companies should conduct risk-based human rights and environmental due diligence in line with the six steps defined by the Organisation for Economic Co-operation and Development (OECD) Due Diligence Guidance for Responsible Business Conduct, by carrying out the following actions:

- ▶ **Integrate due diligence into all their relevant policies and risk management systems** and have in place a due diligence policy that ensures a risk-based due diligence. The due diligence policy should include a description of the company's approach, a code of conduct, and a description of the processes put in place to integrate due diligence, including measures to verify compliance.

Companies should update their due diligence policy without undue delay after a significant change occurs, and review, and where necessary, update it at least every 24 months.

- ▶ **Identify and assess actual or potential adverse impacts**, and where necessary, prioritize potential and actual adverse impacts, such as child labor, labor exploitation, pollution, deforestation, and damage to ecosystems. Such obligations mean to take appropriate measures to map and carry out an in-depth assessment of the relevant operations in order to identify general areas where adverse impacts are most likely to occur and to be most severe.

Companies are entitled to make use of appropriate resources to gather quantitative and qualitative information, including independent reports and information gathered through the notification mechanism and complaints procedure. In order to conduct meaningful human rights and environmental due diligence, companies should take appropriate measures to carry out effective engagement with stakeholders, for the process of carrying out the due diligence actions.

- ▶ **Prevent and adequately mitigate potential adverse impacts.** Companies should be required to take the following appropriate measures:
 - ▶ Develop and implement a prevention action plan (perhaps in cooperation with industry or multi-stakeholder initiatives) with reasonable and clearly defined timelines for the implementation of appropriate measures and qualitative and quantitative indicators for measuring improvement.
 - ▶ Seek contractual assurance from a direct business partner that it will ensure compliance with the company's code of conduct and a prevention action plan. The contractual assurances should be accompanied by the appropriate measures to verify compliance, such as, independent third-party verification.
 - ▶ Make necessary financial or nonfinancial investments, adjustments or upgrades, such as into facilities, production or other operational processes and infrastructures.
 - ▶ Make necessary modifications of, or improvements to, the company's own business plan, overall strategies and operations, including purchasing practices, design and distribution practices.

The prevention action plan should be adapted to a companies' operations and chain of activities.

- ▶ **Bring actual adverse impacts that have been, or should have been identified, to an end.** Appropriate measures include neutralizing the adverse impact or minimizing its extent; developing and implementing a corrective action plan; seeking contractual assurance; and making necessary financial or nonfinancial investment adjustments or upgrades, or to the business plan, overall strategies and operations.
- ▶ **Remediate actual adverse impacts.** Companies that have caused or jointly caused an actual adverse impact, should provide remediation. Where the actual adverse impact is caused only by the company's business partner, voluntary remediation may be provided by the company. The company may also use its ability to influence the business partner causing the adverse impact to enable remediation.

- ▶ **Carry out effective engagement with stakeholders**, by providing relevant and comprehensive information in order to carry out effective and transparent consultations. Stakeholders mean the company's employees, the employees of its subsidiaries, trade unions and workers' representatives, consumers. They also include other individuals, groups, communities or entities whose rights or interests could be affected by the products, services and operations of that company, its subsidiaries and its business partners, including the employees of the company's business partners, trade unions and workers' representatives, national human rights and environmental institutions, civil society organizations.
- ▶ **Establish and maintain a notification mechanism and complaints procedure** with people or organizations that have legitimate concerns regarding actual or potential adverse impacts. Companies should establish a fair, publicly available, accessible, predictable and transparent procedure for dealing with complaints, and take measures to prevent retaliation of submitters of complaints.
- ▶ **Monitor the adequacy and effectiveness of their due diligence policy and measures**. Companies should carry out periodic assessments of the due diligence measures in their own operations and supply chain, to assess the implementation and effectiveness of the identification, prevention, mitigation, bringing to an end, and minimization of adverse impacts. Assessments should be based on qualitative and quantitative indicators and carried out at least every 12 months, and include information from stakeholders.
- ▶ **Report their due diligence policy and measures**, with a description of due diligence, potential and actual adverse impacts identified, and appropriate measures taken with respect to those impacts, in accordance with the dispositions of the Corporate Sustainability Reporting Directive (CSRD)¹.

¹ Companies reporting under CSRD are not expected to submit an additional report for CS3D; they integrate CS3D implementation details into their existing CSRD reports.

Large EU companies will be required to adopt and put into effect a transition plan for climate change mitigation which aims to ensure, through best efforts, compatibility of the business model and strategy of the company with the transition to a sustainable economy and with limiting global warming to 1.5°C. This includes developing the plan, putting it into action, and confirming that the plan is appropriate for achieving the Paris Agreement objectives. The transition plan should be updated every 12 months and include a description of the progress made by the company.

Which are key definitions to pay attention to?

- ▶ The definition of **chain of activities** includes:
 - ▶ Activities of a company's **upstream business partners** related to the production of goods or the provision of services by the company, including the design, extraction, sourcing, manufacture, transport, storage, and supply of raw materials, products or parts of the products and development of the product or the service.
 - ▶ Activities of a company's **downstream business partners** related to the distribution, transport and storage of the product, where the business partners carry out those activities for the company or on behalf of the company, excluding the distribution, transport, storage of product being subject to export control.
- ▶ **Business partner** is defined as an entity with whom the company has a commercial agreement related to the operations, products or services of the company or to whom the company provides services ("direct business partner"). It applies as well to an entity which performs business operations related to the operations, products or services of the company ("indirect business partner").

Is there independent third-party verification?

- ▶ **Companies may use independent third-party verification** on the company or parts of its chain of activities to support the implementation of due diligence obligations (such as contractual assurance) to the extent that such verification is appropriate to support the fulfilment of the relevant obligations. Third-party verification may be carried out by an expert or multi-stakeholder initiative, i.e., a combination of voluntary due diligence procedures, tools and mechanisms, developed and overseen by governments, industry associations, interested organizations, including civil society organizations.
- ▶ With regards to the potential adverse impacts that could not be prevented or adequately mitigated by the appropriate measures, the **company may seek contractual assurances with an indirect business partner**, with a view of achieving compliance with the company's code of conduct or a prevention action plan. Contractual assurance should be accompanied by the appropriate measures to verify compliance. The company may refer to independent third-party verification, including through industry or multi-stakeholder initiatives.
- ▶ **Independent third-party verifiers should act with objectivity and complete independence** from the company, be free from any conflict of interests, remain free from external influence, whether direct or indirect, and should refrain from any action incompatible with their independence. According to the nature of the adverse impact, they should have experience and competence in environmental or human rights matters and should be accountable for the quality and reliability of the verification.

Will guidelines be published?

- ▶ Guidelines are expected to be developed by the European Labour Authority, European Environment Agency, European Union Agency for Fundamental Rights, or other international organizations with expertise in due diligence. These guidelines will include guidance and best practices for conducting due diligence, practical guidance on transition plans, sector-specific guidance for the sectors listed in the scope, stakeholder engagement, and information sharing.
- ▶ In collaboration with Member States, the European Commission should issue guidance setting out fitness criteria and a methodology for companies to assess the fitness of third-party verifiers, and guidance for monitoring the accuracy, effectiveness and integrity of third-party verification.

What about penalties?

- ▶ **Companies can be held liable** for damage caused to a natural or legal person if the company intentionally or negligently failed to comply with its due diligence obligations concerning the prevention and mitigation of adverse impacts.
- ▶ It should be noted that a **company cannot be held liable** for damage caused exclusively by its business partners in its chain of activities.
- ▶ Individuals or organizations, including trade unions and civil society groups, have a **five-year window** to file claims related to adverse impacts.
- ▶ Non-compliance is sanctioned with pecuniary **penalties of up to 5% of the company's net global turnover**.

Who is the competent authority for oversight and enforcement?

- ▶ For EU companies, the competent national authorities will be in the Member State where the company has its registered office. For non-EU companies, it will be the Member State where the company has a branch.
- ▶ In cases the company does not have a branch in any Member State, or has branches located in different Member States, the competent Member State should be where the company generated the highest net turnover in the Union in the financial year preceding the last financial year.

When will it take effect?

Member States should transpose the CS3D into national law two years from the entry into force. The provisions of the Directive would then apply:

- ▶ **Three years from the entry into force of the Directive**, to companies with more than 5,000 employees on average and more than €1.5 billion net worldwide turnover in the last financial year. Reporting should apply for financial years starting on or after 1 January 2028.
- ▶ **Four years from the entry into force of the Directive**, to companies with more than 3,000 employees on average and more than €900 million net worldwide turnover in the last financial year. Reporting should apply for financial years starting on or after 1 January 2029.
- ▶ **Five years from the entry into force of the Directive**, to companies with more than 1,000 employees on average and more than €450 million net worldwide turnover. Reporting should apply for financial years starting on or after 1 January 2030.

How can you prepare today?

- ▶ Identify whether you are within the scope of the CS3D.
- ▶ Assess how your current due diligence policies compare to these new requirements.
- ▶ Identify gaps and determine the necessary steps to address them.
- ▶ Consider how you can use the CS3D as an accelerator to your sustainable business strategy and how to fully realize the benefits of its adoption.
- ▶ Identify key stakeholders that could give input to your due diligence efforts and find ways to involve them.
- ▶ Formulate a new strategy for CS3D compliant due diligence in your own operations and value chain. Prioritize potential and actual adverse impacts based on the likelihood and severity of risk, and implement measures of those impacts. Consider the challenges and explore your options.
- ▶ Assign accountability for compliance with the CS3D requirements within your organization and define roles for execution and monitoring.
- ▶ Seek additional support and guidance where needed, such as from industry associations and databases.

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