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EXECUTIVE SUMMARY OF THE IMPACT ASSESSMENT REPORT

Accompanying the document

Proposal for a

DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL

on Corporate Sustainability Due Diligence and amending Directive (EU) 2019/1937

{COM(2022) 71 final} - {SEC(2022) 95 final} - {SWD(2022) 38 final} -
{SWD(2022) 39 final} - {SWD(2022) 42 final}

Executive Summary Sheet
Impact assessment on a proposal for a Directive on sustainable corporate governance
A. Need for action
What is the problem and why is it a problem at EU level?
The main problem addressed is the **need to reinforce sustainability in corporate governance and management systems**, with two dimensions: 1) **stakeholder interests and stakeholder-related (sustainability) risks to the company** are **not sufficiently taken into account** in corporate risk management systems and decisions; 2) companies do **not sufficiently mitigate their adverse human rights and environmental impacts**, do not have adequate governance, management systems and measures to mitigate their harmful impacts. Problem **drivers** are **market failures**, like short-term focus of companies and directors, and **regulatory failures** from unclear and diverging national rules (including emerging ones) and ineffective voluntary frameworks. The problem has an **EU dimension** as companies and investors operate across borders, supply chains are transnational and the identified market failures are systemic. The problem is **expected to grow over time**: identification of risks and awareness are expected to improve, but change is not expected to be sufficiently quick, even, systemic and wide-spread.
What should be achieved?
The **general objective** is to exploit better the potential of the single market to contribute to the transition towards a sustainable economy, and to foster sustainable value creation and improve long-term performance and resilience of EU companies. **Specific objectives** are: clarifying what is expected from directors to fulfil their duty to act in the company's interest; fostering the integration of sustainability risks and impacts into corporate risk management; increasing accountability for identifying, preventing and mitigating adverse impact, including in value chains; improving access to remedy; improving corporate governance practices to better integrate sustainability into directors' and company decision-making.
What is the value added of action at the EU level (subsidiarity)?
Individual action of some Member States **could not satisfactorily achieve the objectives,** due to the EU/global dimension of the problem. EU rules have better chances to mitigate short-term pressures on companies. New EU rules would build on the existing EU corporate governance framework. EU intervention can ensure a strong EU voice globally.
B. Solutions
What are the various options to achieve the objectives? Is there a preferred option or not? If not, why?
Options were considered mainly for corporate due diligence duty and directors' duties. Non-regulatory options were discarded as they have proven not to be effective and efficient. On due diligence, certain regulatory options (e.g. duty or liability limited to value chain first tier) were also discarded due to ineffectiveness. Retained options vary in overall approach (sectoral – horizontal) and personal scope. A **preferred package of options, which complement each other, is proposed.** As regards **corporate due diligence,** a horizontal due diligence duty would be introduced for large limited liability companies (LLC) (defined by two possible alternative sets of employee number and turnover criteria) combined with a simplified regime targeting most salient issues for medium-sized and midcap LLCs in sectors where environmental and human rights adverse impacts are more likely to occur (high-impact sectors). EU rules on harmonised civil liability and administrative enforcement would support this. Third-country companies generating significant turnover in the EU will be included. On **directors' duties,** the preferred option would clarify in a harmonised manner the general directors' duty to act in the company's best interest for all LLC (regulated in national company laws). This would be underpinned by some specific directors' duties (e.g. relating to risk management, or stakeholder engagement) for large companies and phased in

for high-impact medium-sized LLCs and listed SMEs. Directors' duties implementing the corporate due diligence obligation apply to the same companies as that obligation. Additional specific directors' duties relating to strategy setting with science-based targets would apply to large companies with more than 1000 employees. A general clause that **remuneration** should facilitate or at least not hinder compliance with the new rules would complement this.
What are different stakeholders' views? Who supports which option?
The consultative activities, in particular the public consultation yielding almost half a million responses, show overall support for the objective for EU action and the majority of the proposed actions. On **directors' duties**, the majority of respondents across stakeholder groups recognized the need for companies and directors to take account of stakeholders` interests in corporate decisions, especially as regards integrating sustainability into corporate strategy, with the largest support from NGOs, followed by individual companies and business associations. Those latter express concern on setting measurable targets and balancing the interests of all stakeholders. On **corporate due diligence**, all stakeholder groups confirm with vast majority the need for a horizontal EU legal framework, providing for harmonisation, level playing field and legal certainty. There is overall support for an ambitious approach as regards the content of a due diligence duty, along the lines of the preferred option. As regards reducing the burden on SMEs, measures such as a toolbox, national helpdesks, capacity-building support, including funding, and non-binding guidelines, are considered effective. **Remuneration** seems recognized as complementary, with somewhat limited replies.
C. Impacts of the preferred option
What are the benefits of the preferred option (if any, otherwise of main ones)?
The package of preferred options would allow **companies** to improve financial performance, based on different factors such as better risk management, improved operational efficiency and cost savings, better resilience, more innovation. Not all benefits will arise immediately, some may manifest in the medium to long-term, nor will they arise equally to all companies in the scope. Positive **impacts on human rights**, including labour rights, **and on the environment** are expected, also in third countries where supply chains are located. The preferred package would be effective in achieving those benefits.
What are the costs of the preferred option (if any, otherwise of main ones)?
Compliance costs for companies consist of the costs of establishing and operating due diligence processes and procedures, as well as transition costs, i.e. expenditures and investments necessary to change the company's own operations and value chains to mitigate adverse impacts. Additional cost of reporting to the public will be incurred only by high-impact non-listed medium-sized companies as they are not covered by the Commission's proposal on the Corporate Sustainability Reporting Directive. Estimated direct compliance costs taking into account the number of companies affected amount to one-off costs of EUR 500 to 680 million, and EUR 1.72 to 2.37 billion recurrent (annual) costs (depending on the selected employee number / turnover criteria to define large companies covered by full due diligence rules). Some companies (subsidiaries, value chain partners) that are not under the scope of the initiative would bear indirect (trickle-down) costs. Directors' duties will imply a one-off cost of EUR 445 million, while the cost impact of remuneration is very limited.
What are the impacts on SMEs and competitiveness?
Under the preferred package, small and micro companies are excluded from due diligence measures; medium-sized and midcap companies are only covered when active in particularly high-impact economic sectors with more targeted obligations and phased-in. As described, an indirect effect is expected on all companies that are part of value chains; the preferred package therefore includes measures to prevent that the burden of compliance is put on SME value chain partners, while additional support measures will also help minimise the costs for SMEs. Overall, the preferred option should lead to improvements in company resilience, long-term performance (see "Benefits"), in particular in the mid to long-term, bringing about

similar benefits at the level of the economy. As the cost impact is relatively low compared to the revenue of companies, no significant negative distortions are expected as regards the competitiveness of EU companies in global markets and the mid to long-term competitiveness impacts are expected to be positive.
Will there be significant impacts on national budgets and administrations?
Under the preferred option, the total supervisory costs for the public administration in all Member States would amount to a one-off cost of EUR 0.13 million and an annually recurrent cost of EUR 7.86 to 11.2 million (depending on the selected employee number / turnover criteria to define large companies covered by full due diligence rules). These calculations apply to the risk-based supervisory review as regards due diligence compliance. No additional supervisory costs are expected for the directors' duties and remuneration part. Member States may also incur some low additional enforcement costs from litigation.
Will there be other significant impacts?
Due to the global outreach via value chains, third-country companies and economies will be affected. Positive effects are expected on human rights and the environment, and on local communities, through increased stakeholder awareness, improved sustainability-related practices, increased adoption of international standards in developing nations, better access to remedy for victims, sustainable investment. Potential negative impacts include: compliance costs on third-country companies, and subsequent moving of producers from third countries to uncontrolled product markets; the risk of companies switching to less risky suppliers. Mitigation measures are described.
Proportionality?
The proposed measures do not go beyond what is necessary to address the drivers and achieve the objectives of the initiative. Burden on companies stemming from compliance costs, has been adapted to the size and resources available to the company, and the risk profile (see also on impacts on SMEs above).
D. Follow up
When will the policy be reviewed?
5 years after transposition, taking account of the time needed for application and data collection.