THE DANISH INSTITUTE FOR HUMAN RIGHTS

JULY 2023

DANISH INSTITUTE FOR HUMAN RIGHTS – COMMENTS TO THE DRAFT ESRS DELEGATED ACT

The Danish Institute for Human Rights (the Institute) welcomes this opportunity to provide comments to the Commission draft Delegated Act on the European Sustainability Reporting Standards (ESRS) - henceforth "Commission draft Delegated Act". We refer to our previous consultation responses on the Corporate Sustainability Reporting Directive Adopted Act from July 2021, the Institutes High Level Input on the European Sustainability Reporting Standards during the consultation in August 2022, as well as Five Points on the European Sustainability Reporting Standards provided to the Danish Business Authority to the European Financial Reporting Advisory Group (EFRAG) SET 1 ESRS in January 2023. These consultation responses build on the previous work of the Institute related to corporate reporting and human rights including a the report "Sustainability reporting and human rights -What can big data analysis tell us about corporate respect for human rights?", as well as Corporate Human Rights Benchmark snapshots of the [20/30] largest Danish companies' reporting on human rights "Documenting Human Rights – A Snapshot of Large Danish Companies" from 2020 and 2022.

In our previous consultation responses, we have emphasised:

- ***The importance of clarity on the double materiality concept***: One of the key innovations of the ESRS is its implementation of the double materiality approach, which will be key to ensuring that future reports adequately reflect risks to people and planet alongside risks to the undertaking. Here the ESRS has seen much improvement on the way in which this concept has been clarified and explained in alignment with the expectations of the UN Guiding Principles on Business and Human Rights and the OECD Guidelines, clarifying that due diligence enables preparers to identify impacts that are material from an impact materiality perspective. We are also pleased to note that EFRAG will be producing additional guidance material on materiality assessment and will be following this process closely to ensure full alignment with the human rights due diligence expectations on the undertaking.
- ***Alignment of due diligence steps as outlined in the UNGPs and OECD GL***: Here we have emphasized that the description of the process for and outcome of the impact materiality assessment is relevant not only at the cross-cutting level of ESRS 2, but also at the level of the topical standards. This continues to be unclear, also in the Commission draft Delegated Act.
- ***Cross-topical reporting***: Whilst the division in topical standards is intuitive and clear, it comes with the risk of driving siloed approaches to integrated sustainability matters. It is not entirely clear how preparers are encouraged to reflect on and disclose the interrelations between the E, S and G impacts. Specifically, from a human rights perspective, environmental, climate, tax or corruption impacts all could be associated with human rights impacts. And we have noted the need to allow preparers to consider and disclose information around cross-topical aspects of their material sustainability impacts.
- ***Policy coherence***: We have noted in our submissions the need to further clarify how the disclosure needs of the forthcoming Corporate Sustainability Due Diligence Directive will be reflected in the ESRS. Accordingly, the Institute continues to encourage alignment to the greatest extent possible between these two parallel measures.
- ***Full value chain approach***: The Institute has expressed it support for the ESRS requiring reporting undertakings to consider the full value chain, including the downstream, when assessing impact materiality. Taking such an approach will help to ensure that critical impacts are not overlooked, particularly for companies whose most severe risks occur in the downstream part of the value chain, such

as those in the tech sector. To further exemplify how companies are conducting Human Rights Due Diligence in the Downstream, please view this publication from start 2023 "Due Diligence in the Downstream Value Chain – Case Studies of Current Company Practice"(additional case studies forthcoming).

Based on our previous analysis we are concerned that the Commission draft Delegated Act departs from the EFRAG's technical advice from November 2022 in a number of areas as noted below. We find that these departures can serve to further complicate company disclosures, as well as undermine the much-needed progress as well as already existing good practices on due diligence of companies in certain areas. The departures include in particular subjecting all standards to materiality assessment (with the exception of the ESRS 2 "General Disclosures"), introducing additional phase-in rules, making disclosures voluntary on the conclusions from materiality assessment as well as characteristics and working conditions for non-employees, as well as excluding disclosures on unlawful use or misuse of the undertaking's products and services by consumers and end-users. Departures in these areas will not only have the potential to undermine company performance on expectations from the OECD as expressed through the updated OECD Guidelines for Multinational Enterprises and the UN Framework and Guiding Principles on Business and Human Rights, but may also be misaligned with the expectations on companies to conduct due diligence on adverse human rights and environmental impacts with respect to their own operations, the operations of their subsidiaries, and the value chain operations carried out by entities with whom the company has a business relationship, as outlined in the proposed Corporate Sustainability Due Diligence Directive (CSDD) of the EU. Finally, lack of disclosures in these areas can pose risk to investors that may be looking for relevant information to assess company due diligence efforts and may also impact their ability to provide adequate reporting under their own reporting requirements under the Sustainable Finance Disclosure Regulation, see Joint statement from IIGCC, PRI and Eurosif on EU reporting standards.

SPECIFIC COMMENTS ON THE MAIN TEXT OF THE DRAFT DELEGATED ACT

MATERIALITY

Under the Commission draft Delegated Act, all standards, including relevant disclosure requirements and data points, are subject to a materiality assessment, except for ESRS 2 "General disclosures". This departure from EFRAG's technical advice poses the risk that important information may not be disclosed as a result of a poor methodological approach to a materiality assessment, resulting in companies omitting entire disclosures or necessary details within a single disclosure. Accordingly, it is critical that companies disclose the methodology and assumptions of their materiality assessment to ensure transparency and enable information users to assess the adequacy of the materiality assessment. As such, the change to article ESRS 2, article 57 (see below) presents a key challenge as it makes the disclosure on the conclusions from the materiality assessment voluntary rather than mandatory as envisaged by EFRAG.

Further, it makes little sense to subject the topical standard on climate change to a materiality assessment given the urgency of the challenge, and the clear links between environmental damage and negative impacts on human rights (see UN Resolution on the right to a clean and healthy environment).

- ***The Institute recommends that the Commission reverse this change from the EFRAG's technical advice and mandate companies to disclose on the process and the outcome of the materiality assessment, as well as mandating disclosures on scope 1, 2 and 3 green-house-gas emissions.***

ADDITIONAL PHASE-IN RULES

The Commission draft Delegated Act proposes additional phase-in rules that unnecessarily delay the transition and implementation of the CSRD. The CSRD already prescribes a gradual application of the disclosure requirements drawing on the size and type of undertaking (see Art. 5 CSRD). In addition, EFRAG's technical advice already suggested phased-in requirements for specific disclosures, including value chain metrics (3 years), quantitative data on financial effects from environment related risks (3 years), and certain indicators with regard to non-employees (1 year). The additional phase-in rules set out by the Commission further complicate the transition schedule and are likely to cause confusion on the part of preparers.

- ***The Institute recommends removing the phasing-in of standards. As it is clearly stated in the CSRD that companies are under the obligation to identify and assess their material impacts, risks and opportunities in these areas and report on their actions to address them, the Commission should, if wanting to maintain the delay, clarify that the delay for application of these standards does not remove this obligation.***

DISCLOSURE REQUIREMENTS BECOMING VOLUNTARY

The Commission draft Delegated Act converts several mandatory datapoints into voluntary datapoints (see specific references in the table below), regardless of their materiality. These changes concern the cross-cutting as well as the topical standards, including:

- An explanation of the conclusions of the materiality assessment (see above) (ESRS 2 57)
- Information on non-employees when it comes to:
    - Characteristics of non-employees in the undertaking's own workforce (ESRS S1 53-57)
    - Collective bargaining coverage and social dialogue (ESRS S1 58-63)
    - Adequate wages (ESRS S1 67-71)
    - Social protection (ESRS S1 72-76)
    - Training and skills development metrics (ESRS S1 81-85)
    - Health and safety metrics (ESRS S1 86-90)

<u>Non-employees</u>

Given that the information in ESRS S1 is already subject to a materiality assessment, undertakings only need to disclose relevant data on non-employees where the topic is deemed relevant from a double materiality perspective. Making disclosures on non-employees voluntary defeats the purpose of providing investors and other stakeholders with *material* sustainability information. If there are material impacts on their own workforce, including non-employees, companies must be required to report the necessary datapoints to put investors and other stakeholders in the position take this information into consideration.

These changes are particularly concerning as non-employees have been recognised as being most vulnerable to human rights abuses related to their employment. Non-employees may include different types of contracted labour, e.g. seasonal/short term workers and often migrant workers, contracted to perform tasks in company premises alongside company employees. Migrant workers are recognized internationally[1] as being particularly vulnerable to labour rights abuses, and these abuses often have to do with:

- lack of representation and ability to bargain collectively (as illustrated clearly through the numerous cases gathered yearly by the International Trade Union Confederation, ITUC Survey of violations of trade union rights (ituc-csi.org), where migrant workers are directly excluded and actively discouraged (sometimes with the use of violence) from association in trade unions).
- Lack of adequate wages (as illustrated through the ILO report The migrant pay gap: Understanding wage differences between migrants and nationals, which highlights that the wage gap between migrant workers and national workers may differ with as much as 42 per cent, leaving the workers in situations where they may have to work significant overtime as well as several jobs to earn enough to make a living for themselves and their legitimate dependents).
- Social protections (as illustrated by the ILO activities on migrant workers and social security, highlighting the challenges migrant workers often face when accessing social security services – especially when it comes to long-term benefits associated with work related invalidity due to workplace accidents.
- Unhealthy and unsafe working conditions (as illustrated by the ILO activities on migrant workers health and safety conditions where their vulnerability in terms of unhealthy and unsafe conditions of work are highlighted).

In a 2021 report commissioned by the EU on Intra-EU mobility of seasonal workers, similar challenges regarded contracted seasonal workers the EU agricultural and hospitality sectors are highlighted.

The elevated risk factors above are covered by disclosure requirements which are now voluntary in the Commission draft Delegated Act. From a materiality perspective on social impact these types of impacts have on non-employees would often be deemed material, however the voluntary nature of disclosures allows the disclosing undertaking not to include this information in their disclosure even if material.

A range of authoritative standards and frameworks make specific reference to "workers" and not "employees". This includes the OECD which set expectations on multinational enterprises providing adequate and safe working conditions for workers in their chapter V. Employment and Industrial Relations of the OECD Guidelines for Multinational Enterprises., The International Finance Corporation goes into detail on the expectations to be placed on performance of investees towards workers in their Performance Standard 2 where they include three categories of workers: Direct Workers, Contracted Workers and Supply Chain Workers. When it comes to Contracted workers, the performance standards regarding health and safety apply, and the third party contracting the work must ensure that the conditions of work are aligned with those of direct workers as outlined in the standard, including adequate working conditions and terms of employment as well as workers' organisations.

There is little evidence to suggest that a requirement to make disclosures on non-employees would be unduly burdensome. Many companies already have established records and processes aimed towards reporting on non-employee workers, see e.g. authoritative reporting frameworks such as the GRI with their disclosure expectations in the Global Reporting Initiative 2.

- ***The Institute recommends that explanation of the conclusions of the materiality assessment and information on non-employees are reported on mandatorily.***

CLARITY ON STAKEHOLDER ENGAGEMENT

The Commission draft Delegated Act changes the disclosure requirement under *SBM-2 – Interests and views of stakeholders*, by including the word "key" before stakeholder, making it "key stakeholder", two times in the proposed section. The term "key stakeholders" also appears two other places in the Commissions draft Delegated Act: in the ESRS 2 64 and ESRS E 4 Annex A, AR19. Determining which stakeholders are "key" is left to the discretion of the disclosing undertaking and there are no additional detail or disclosure requirements on how "key" should be understood and assessed. The double materiality approach already provides the disclosing undertaking with an approach to determining which groups and stakeholders should be considered, thus defeating the need to add the word "key". Further the concept of "key stakeholders" is not used in authoritative guidance and frameworks, e.g. United Nations Guiding Principles on Business and Human Rights uses the terms relevant or affected stakeholders. Due to the importance placed on stakeholder engagement for human rights due diligence, it is crucial that the terms used to describe stakeholders do not create unclarity or confusion.

- ***The Institute recommends that the word "key" in "key stakeholders" (under SBM-2 – Interests and views of stakeholders) be removed.***

UNLAWFUL USE AND MISUSE

The Commission draft Delegated Act has included in the text an additional paragraph 4 in ESRS S4 indicating that the unlawful use or misuse of the undertaking's products and services by consumers and end-users fall outside the scope of this standard. The Commission draft Delegated Act also removes central passages in ESRS S4 5 and 6 that cover on disclosures on impacts that can emerge from the undertakings business model(s) or strategy (5) and impacts on consumers and/or end-users that originate in the strategy or business model(s) (6), where examples such as "providing products that harm when overused, misused or when used as intended" is removed in section 5, and examples such as the "the undertaking's business model(s) depends on the use of facial recognition technology in its products, where these capabilities are misused by third parties to track and persecute individuals" is removed from section 6. By excluding the unlawful use or misuse of the undertaking's products and services by consumers and end-users a considerable number of downstream challenges fall outside the scope of reported information. Information on unlawful usage on the downstream side of companies' operations, like hate speech on social media platforms or abuse of facial recognition technology, is key for stakeholders to assess the impacts, risks and opportunities of strategies and business models. For examples on guidance on expectations of companies to act with human rights due diligence on these challenges please see the SHIFT Business Model Red Flag nr. 9. Products that harm when misused, and the Foundational Paper of the OHCHR Business and Technology Project B-tech on Taking Action to Address Human Rights Risks Related to End-Use.

- ***The Institute recommends that the statement to exclude the unlawful use or misuse of an undertaking's product (ESRS S4, 4) be removed, and the examples on misuse and unlawful use (ESRS S4, 5-6) be reinstated, as there is clear evidence to suggest that undertakings should-, and already are, considering such risks as a part of their due diligence, particularly in some sectors such as the technology sector.***

SPECIFIC COMMENTS ON ANNEX I

Standard	Paragraph or AR number or appendix	Comment
ESRS 2	*SBM-2 – Interests and views of stakeholders*	The word "key" should be removed as it provides more uncertainty than clarity.
ESRS 2	***57***	Reinstate that companies "shall" disclose on the outcome of materiality assessments.
ESRS S4	***4-6***	Remove ESRS S4, section 4 in the objectives section which states that unlawful use or misuse of the undertaking's product and services are outside the scope of the standard, as this will be important disclosures. Reinstate examples of unlawful use and misuse in ESRS 5-6. As these concerns are aligned with already existing considerations and resources available to the undertakings to which these types of considerations as well as the concrete examples would apply.
ESRS S1	***53-57***	Remove the voluntary nature of data-points on the role of non-employees to improve transparency on how the disclosing undertaking use and rely on this category of workers.
ESRS S1	**58-63**	Remove the voluntary nature of data-points on collective bargaining coverage and social dialogue of non-employees as this group of workers are more vulnerable to lack of access to rights in these areas (as noted above).
ESRS S1	***67-71***	Remove the voluntary nature of data-points on adequate wage for non-employees as this group of workers are more vulnerable to lack of access to rights in this area (as noted above).
ESRS S1	***72-76***	Remove the voluntary nature of data-points on social protection for non-employees as this group of workers are more vulnerable to lack of access to rights in this area (as noted above).
ESRS S1	***81-85***	Reintroduce requirements to disclosure on trainings and skills development of non-employee workers, as this will allow more emphasis on the role in supporting skills development of e.g. contracted labour. Skills that may also be relevant to their health, safety and working conditions.
ESRS S1	***86-90***	Reintroduce requirements to disclosure cases of recordable work-related ill health, the number of days lost to work-related injuries, fatalities from work-related accidents, work-related ill health, and fatalities from ill health, for non-employees, as this group of workers are more vulnerable to adverse impacts in this area (as noted above).