

JULY 2023

CONSULTATION RESPONSE TO THE REVIEW OF THE SUSTAINABLE FINANCE DISCLOSURE REGULATION

The DIHR welcomes the opportunity to participate in [the consultation](#) by the European Supervisory Authorities on the review of the EU [Sustainable Finance Disclosure Regulation](#) (SFDR) regarding principal adverse impacts (PAI) and financial product disclosures (the Consultation). SFDR aims to set up a transparency regime on sustainability for financial market participants (FMPs) such as asset managers, pension funds, insurance companies, financial advisers, to scale up their consideration of negative environmental or social risks and impacts in investment decisions or financial advice.

Some of the provisions of SFDR have been in force since March 2021. In 2022, the European Commission adopted the Delegated Regulation (EU) 2022/1288 with the regulatory technical standards (RTS) specifying the content, methodology and presentation of the reported information. The current consultation proposes amendments to these regulatory technical standards, including expanding and modifying the list of mandatory and optional social indicators that FMPs are expected to report on. The DIHR's submission focuses on the suggested amendments to the social indicators, but also raises some broader concerns about alignment with international business and human rights standards which go beyond the scope of the present consultation.

The DIHR response draws from the expertise of the Human Rights and Business Department, which has worked for 20 years with companies, states and civil society to build a global environment in which negative impacts on human rights by business activities are minimised, including through implementation of the UN Guiding Principles on Business and Human Rights. It builds on a prior submission made to the first consultation on RTS organised by the Supervisory Authorities in 2020.¹

Below is a slightly amended version of the DIHR's response to the Consultation questions submitted to the European Supervisory Authorities in the standard questionnaire format.

ALIGNMENT WITH INTERNATIONAL STANDARDS

The current RTS continue to have gaps vis-à-vis international standards on responsible business conduct such as UN Guiding Principles on Business

and Human Rights (UNGPs) and OECD Guidelines on Multinational Enterprises (OECD Guidelines).

¹ [Joint ESA consultation on ESG disclosures \(europa.eu\)](#)

This leads to a situation whereby the regulation sets a lower standard for disclosure than what many responsible investors are committed to (see, for example, PRI's [Why and How Investors Should Act on Human Rights](#)). One important area of misalignment is the expectation that financial market participants (FMPs) should primarily report on a pre-defined list of principal adverse impacts (PAI) indicators. Introducing indicators that are predetermined to constitute principal adverse impact takes a different approach to that of the main standards on responsible business conduct which require businesses, including investors, to identify through due diligence their potential and actual human rights impacts and take action to prevent and mitigate such impacts. When doing so, entities are asked to consider *all* human rights and identify those most at risk of adverse impacts related to business activities. By including some human rights and not others in the list of indicators in the Consultation paper, aside from not being fully aligned with the international standards, the regulator risks driving due diligence attention and efforts towards some human rights only at the expense of consideration of all impacts and prioritisation of those most severe. To mitigate these risks, it is important that the regulator requires FMPs, as a first step, to describe their own identification of main human rights risks and impacts in recognition of the fact that the principal adverse impacts of most relevance to their activities may well differ from the ones represented through mandatory indicators. This would require making changes to

articles 6,7, 8 of the RTS and modifying Table 1 "*Statement on principal adverse impacts of investment decisions on sustainability factors*" in Annex 1 of the RTS accordingly.²

While the DIHR appreciates that addressing this concern goes beyond the scope of the current consultation, it is a critical issue that needs urgent attention. The comprehensive assessment of the SFDR starting in autumn 2023 and announced by the Commission in its [sustainable finance package](#) published in June 2023 is a timely opportunity to address this structural concern.

NEED FOR EU POLICY COHERENCE

The DIHR welcomes the efforts in this Consultation to seek closer alignment of the PAI indicators with the metrics in the draft [Environmental and Social Reporting Standards](#) (ESRS) published by European Financial Reporting Advisory Group (EFRAG) in November 2022 to enable compliance with the [Corporate Sustainability Reporting Directive](#) (CSRD). There are clear linkages between ESRS and SFDR as the data reported by companies in scope of CSRD can support investors' reporting under SFDR. Alignment with the CSRD and ESRS is an important step towards EU policy coherence; it also has the potential to simplify data collection processes and enable compliance with SFDR.

² The RTS are included in the European Commission Delegated Regulation (EU) 2022/1288.

There is, however, a need for a more sophisticated and nuanced approach to connecting the two disclosure frameworks. Some draft ESRS metrics have been imported in a decontextualised manner without a supporting explanation in the Consultation paper as to how these metrics are a meaningful proxy for FMP's adverse impacts. This risks making them unreliable proxies for FMP's adverse impacts on human rights and labour rights. For example, in respect to the 3 newly introduced opt-in indicators on excessive use of non-guaranteed hour employees, temporary contract employees, and non-employee workers, the draft ESRS do not set a threshold of what is considered an 'excessive use' thereof as implied by the framing in the Consultation paper. According to the draft ESRS, the purpose of these disclosures is to "(...) provide contextual information that aids an understanding of the information reported in other disclosures"³. Specifically, *"Quantitative data, such as the number of temporary or part-time employees, is unlikely to be sufficient on its own. For example, a high proportion of temporary or part-time employees could indicate a lack of employment security for employees, but it could equally signal workplace flexibility when offered as a voluntary choice. For this reason, the undertaking is required to disclose contextual information to help information users interpret the data. (...)"*⁴. In the draft ESRS, such data is one of the many data points required as part of a broader suite of disclosure requirements, including on the quality

of working conditions of employees and non-employees.

Moreover, the import of some draft ESRS metrics as 'mandatory' and some as 'opt in' indicators, respectively, hasn't been substantiated in the Consultation paper, and appears to be the result of an arbitrary – as opposed to carefully reasoned – process.

Finally, the DIHR takes note of para 19 in the Consultation Paper whereby the European Supervisory Authorities have relied on the draft ESRS not only to develop new indicators, but also to align the wording of a number of old PAI with the ESRS. However, it is unclear why the Authorities haven't reviewed *all* PAI indicators in light of the draft ESRS framework. The draft ESRS published by EFRAG represent a consensus amongst a diverse group of stakeholders and are the foundation for company mandatory disclosures that investors can rely on to fulfil obligations under SFDR. Using different or slightly different indicators in SFDR risks fragmenting reporting frameworks, with the unintended effect of undermining the comparability of investor data and eventually reducing the effectiveness of this regulation to improve transparency for end investors.

The DIHR recommends that all social indicators should be revisited in light of the draft ESRS framework with the objective of achieving full compatibility between the SFDR and CSRD

³ See para 50 in draft ESRS S1-6, [Download \(efrag.org\)](https://www.efrag.org)

⁴ See draft ESRS S1, DR S1-6, AR 58, [Download \(efrag.org\)](https://www.efrag.org)

regulations. In this process, the regulator should develop a clear reasoning for (i) which metrics have been imported and which haven't, (ii) why the metrics selected are meaningful proxies for FMP's adverse impacts, (iii) their inclusion in the mandatory and opt-in baskets, respectively. The DIHR takes note of the ongoing consultation by the European Commission on the draft Delegated Act on the ESRS and stress the importance of ensuring that the final ESRS require mandatory disclosure of the data points that FMPs are expected to report on.

NEWLY PROPOSED MANDATORY SOCIAL INDICATORS

The DIHR welcomes the decision in this Consultation to include additional mandatory indicators on human rights/labour rights. The 2 indicators on trade unions and adequate wages⁵ can be further strengthened to yield more meaningful information about the exposure of FMPs to adverse human rights impacts. A policy commitment not to interfere with trade union formation is, of course, important but insufficient to assess whether the investee companies respect trade union rights in practice. We recommend replacing this with a metric that focuses on outcomes as opposed to policies such as "percentage of total employees covered by collective bargaining agreements"⁶ and "estimate

⁵ These new indicators are "*Share of investments in investee companies without commitments on their non-interference in the formation of trade unions or election of worker representatives*" and "*Average percentage of*

of the coverage rate of non-employee workers by collective bargaining agreements"⁷. The indicator on adequate wages should be modified to align with the draft ESRS which require that the data on wages be reported for all workers and not just those in formal employment⁸. It is usually non-employee workers who are most vulnerable to adverse human rights impacts and have no or few channels to seek remediation.

Moreover, the DIHR recommends that the list of mandatory indicators be significantly expanded to align with international standards on responsible business conduct clarifying that businesses including investors can adversely impact *all* human rights. A starting point could be making mandatory indicators that measure (i) the respect of the 4 ILO core standards (i.e. freedom of association and collective bargaining, forced labour, child labour and discrimination), (ii) compliance with wages and health and safety standards, and (iii) the extent to which investee companies have developed and implemented human rights due diligence processes.

CHANGES TO THE OLD SOCIAL INDICATORS

The DIHR welcomes the approach in the Consultation paper to replace the reference to the UN Global Compact Principles with the UNGPs in indicator 10 in Table 1 of Annex 1. This better

employees in investee companies earning less than the adequate wage".

⁶ See draft ESRS S1-8, para 60, [Download \(efrag.org\)](#)

⁷ See draft ESRS S1-8, para 60(c), [Download \(efrag.org\)](#)

⁸ See draft ESRS S1- 10, para 66, [Download \(efrag.org\)](#)

reflects the normative status of these standards in international law and aligns with how the UNGPs have informed other relevant EU regulations that are relevant for the financial sector such as the Taxonomy Regulation (see art 18 on minimum safeguards), CSRD and the proposal for a Corporate Sustainability Due Diligence Directive.

We recommend the following additional changes to the old indicators:

Indicator 10⁹. The indicator leaves ample room for interpretation as there is no authoritative consensus on what amounts to a “violation of OECD Guidelines or UNGPs”. These standards cover both process-related requirements (e.g. adoption of a human rights policy, due diligence process, set-up of a grievance mechanism) as well as outcome-related requirements (e.g. avoiding, mitigating and remediating human rights harm). As such, ‘violation’ can mean qualitatively different things i.e. the non-existence of one or more of the procedural elements, the occurrence of adverse human rights impacts. The lack of guidance on how to interpret this indicator can be problematic for several reasons. First, if ‘violation’ is to be interpreted as the lack of human rights due diligence processes, there is a clear overlap with the opt-in human rights indicators in table 3 of Annex 1 (i.e. lack of human rights policies, lack of due diligence, lack of remediation mechanisms, etc), raising the question as to why those aren’t included in the

mandatory list. That would be preferable given their specificity and clarity. Second, the very different issues that this indicator can potentially measure undermines the comparability of data across FMPs, which is one of the objectives of SFDR. While one FMP might interpret this indicator as a process-related non-alignment, others might interpret it as the existence of human rights harm. However, not having adopted a human rights policy is a qualitatively different type of adverse sustainability impact than subjecting employees to forced labour conditions, for example.

The current formulation of the indicator is likely to obfuscate end investors’ understanding of the seriousness of adverse sustainability impacts of FMPs. The DIHR recommends that this indicator be replaced with more specific indicators measuring the degree of alignment with UNGPs and OECD Guidelines currently included in Table 3 of Annex 1 such as:

- Indicator 13 – lack of human rights policies
- Indicator 14 – lack of human rights due diligence process
- Indicators 5/19/20 – lack of grievance mechanisms for employees and lack of remediation mechanisms for affected communities and consumers

⁹ Share of investments in investee companies that have been involved in violations of OECD Guidelines for Multinational Enterprise or the UN Guiding Principles

including the principles and rights set out in the eight fundamental conventions identified in the ILO Declaration and the International Bill of Human Rights

- Indicator 18 – number of identified cases of severe human rights issues and incidents.

These indicators should be made mandatory.

Indicator 11.¹⁰ The formulation of this indicator is unclear and can be (mis)read to mean slightly different things – e.g. lack of policies to monitor compliance with the OECD Guidelines and UNGPs; lack of grievance mechanisms; and both. It should be noted that the opt-in indicators already include language on grievance mechanisms (see indicators 5, 19, 20 in Table 3 of Annex 1) which raises the question as to why those more specific indicators are not included in the mandatory list. The language of “remediation mechanism” in the new opt-in indicators 19 and 20 in Table 3 can be used interchangeably with that of “grievance mechanism” – according to international standards, grievance mechanisms are formalised processes to enable the remediation of harm suffered by affected parties. If this indicator should be interpreted to mean “lack of policies to monitor compliance with the OECD Guidelines and UNGPs”, there is a clear overlap with the indicators measuring the existence of human rights policy and due diligence system as those are meant to operationalise the responsibility of companies to respect human rights under the OECD Guidelines and UNGPs. The DIHR

recommends clarifying what this indicator is meant to measure and replacing it with the more specific indicators in Table 3. If the indicator seeks to measure the existence of grievance mechanisms, it should be replaced with indicators 5, 19, 20 in Table 3 which should be made mandatory.

Indicator 20.¹¹ The formulation of this indicator is unclear - countries cannot be subject to social violations, it is individuals and communities who usually are. It is assumed that this indicator seeks to capture if FMPs are invested in governments that breached human rights obligations under international human rights law and national law. If that is the case, there are inherent challenges when measuring this indicator. First, there are numerous international instruments covering ‘social issues’. For example, there are 9 core human rights treaties, 190 ILO conventions on labour rights and approximately 100 treaties in the area of humanitarian law. In the absence of specification of which international treaties and conventions should be considered, FMPs and data providers have ample room for discretion in interpreting this indicator, which risks undermining the comparability of data. Moreover, the sheer diversity of human rights issues that this indicator can potentially measure eventually renders it an unreliable proxy for the seriousness of adverse sustainability impacts of different

¹⁰ Share of investments in investee companies without policies to monitor compliance with or with grievance/complaint handling mechanisms to address violations of the OECD Guidelines for Multinational Enterprises or the UN Guiding Principles including the principles and rights set out in the eight fundamental conventions

identified in the ILO Declaration and the International Bill of Human Rights.

¹¹ Number of investee countries subject to social violations, as referred to in international treaties and conventions, United Nations principles and where, applicable, national law.

FMPs. Second, it is unclear what sources should be used to ascertain the existence of a violation – e.g. a court case with a final ruling, a finding of non-compliance by a non-judicial body such as a UN treaty body, a report documenting violations by a reputable civil society organisation. In the absence of clarification of how violations should be identified, the approaches taken by FMPs and data providers will probably be inconsistent and vary from year to year and country to country.

Given the formulation and measurement challenges outlined, we recommend that this indicator be replaced with several indicators measuring specific aspects of a country's human rights performance based on publicly available methodologies. The Principle for Responsible Investment has published a report on [Human Rights in Sovereign Debt](#) which includes a list of indicators and data sources that can be used to inform the revision of this indicator (see p. 10 in the respective report).

REAL ESTATE ASSETS

The DIHR encourages the regulator to develop PAI indicators applicable to the entities managing real estate assets. Human rights organisations have raised concerns about the impacts that the increasing financialisation of housing (i.e. the purchase of real estate assets by financial institutions) has on the affordability and availability of housing, especially for low-income

and vulnerable groups.¹² The DIHR recommends that, at the very least, real estate companies should report on whether their human rights policies include a commitment to the right to adequate housing (as understood in art 11.1 of the International Covenant on Economic, Social and Cultural Rights), whether they have a human rights due diligence process in place and whether they have grievance mechanisms where affected tenants can lodge complaints about the affordability, security of tenure, habitability and accessibility of housing.

INCLUSION OF VALUE CHAIN DATA

The DIHR takes note of the proposal in the Consultation paper to only require FMPs to include information on investee companies' value chains where the investee company discloses value chain data. This aligns with the approach in the draft ESRS published by EFRAG whereby the disclosure of value chain data for workers, communities and consumers/end user is dependent upon a double materiality assessment.

The DIHR notes that companies in scope of CSRD have discretion in conducting and justifying their double materiality assessments and that there will be situations when material value chain human rights risks might not be identified and reported on. Moreover, recital 3 in the draft RTS in the Consultation paper implies that investors can use other sources of data such as third-party data

¹² [Shift Directives. From financialised to human rights based housing](#)

providers- rather than strictly company reported data – in the case of companies not subject to CSRD. The DIHR welcomes the suggestion that investors should seek other data sources but cautions against restricting this approach to companies not in scope of CSRD. In accordance with international standards, investors should be encouraged to seek data from different and multiple sources (e.g. corporate reporting, third party data providers, civil society organisations) to improve their ability to identify, prioritise and address their principal adverse impacts. We recommend that the RTS should be amended to clarify that value chain data for all investee companies should be included if data is available without being prescriptive as to which sources investors should use.

Finally, the DIHR encourages the regulator to assess whether FMPs should be required to report separately on value chain performance. This would add a layer of granularity to the data reported which has the advantage of enabling end investors to assess the nature of human rights impacts in FMPs' portfolios, including whether policies to identify and prioritise impacts and engagement policies (as per art 7 and 8 of RTS) are well geared towards addressing those impacts.