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Positions of the Association of Foreign Banks in Germany

regarding

a proposal for a Directive on Corporate Sustainability Due Diligence

The Association of Foreign Banks in Germany (“**VAB**”) welcomes the opportunity to provide comments on the EU Commission’s proposal for a Directive on Corporate Sustainability Due Diligence (“**Draft Directive**”).

VAB represents the interests of more than 200 foreign banks, investment firms and asset managers from over 30 countries that operate in Germany with subsidiaries and branches to provide banking and financial services here. Almost all foreign financial institutions operating in Germany are organised in VAB.

Our association members are interested in the current discussions and developments on the introduction of corporate due diligence in value chains. As this topic has now also been focused on the European level through the above-mentioned Draft Directive, we would like to use this opportunity to point out the following aspects that specifically concern the banking and financial sector.

The main purpose of the Draft Directive is to encourage sustainable and responsible corporate governance in all global value chains. The concept of the value chain is to be understood very broadly and is intended to encompass the activities associated with the production of a good or the provision of a service by a company. This also includes the development of the product or service and the use and disposal of the product, as well as the related activities of the company's upstream and downstream business relationships. This is to be understood in such a way that not only upstream but also downstream links in the value chain are to be examined, consequently in particular suppliers and customers.

With regard to regulated financial undertakings, Art. 3 (g) of the Draft Directive rules the following in this respect:

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Association of international banks,
investment firms and asset
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„[...] As regards companies within the meaning of point (a)(iv) [i.e. regulated financial undertakings], ‘value chain’ with respect to the provision of these specific services shall only include the activities of the clients receiving such loan, credit, and other financial services and of other companies belonging to the same group whose activities are linked to the contract in question. The value chain of such regulated financial undertakings does not cover SMEs receiving loan, credit, financing, insurance or reinsurance of such entities;”

This provision is almost the only one in the Draft Directive that refers to regulated financial undertakings. The wording of this provision seems to be disconnected from the purpose and objective of the Draft Directive.

The purpose of the Draft Directive is to establish an appropriate and comprehensive due diligence of global value chains by companies. This primarily concerns companies in the manufacturing sector, i.e. the commercial and industrial sector. Thus, the scope of application refers only to the value chain itself and to the direct participants within the value chain of the manufacturing sector.

Against this background, it should be noted that the role of regulated financial undertakings in a value chain is very limited. Banks and other financial undertakings are simply not part of a value chain.

With Art. 3 (g) of the Draft Directive, the EU Commission is apparently attempting to expand the scope of the Draft Directive to include regulated financial undertakings without sufficiently elaborating on the reasons for doing so. The inclusion of regulated financial undertakings in the regulation of value chain participants seems artificial, as it does not fit in with previous regulation efforts of the financial sector.

Based on the following considerations, an introduction of Art. 3 (g) of the Draft Directive would also lead to a regulatory imbalance:

- The inclusion of regulated financial undertakings in the value chain regulation appears disproportionate, as the requirements of Art. 3 (g) of the Draft Directive regarding the provision of *"loan, credit and other financial services"* would mean that financial undertakings would have to establish extensive compliance processes, although they have only limited insight into the value chains of their customers. The proper implementation of the concept of a *"know your client's value chain"* due diligence pursued by the EU Commission poses a considerable challenge for financial undertakings. For example, it is questionable for financial undertakings to what extent such due diligence on the client has to take place. In addition, the Draft Directive does not specify whether this audit should also include the client's value chains. Without an audit of the client's value chains, there is a risk that the *"know your client's value chain"* audit cannot be adequately carried out and that the purpose of the draft directive will thus be nullified. It should be noted, however, that financial undertakings neither have sufficient information about their clients' value chains nor the corresponding professional know-how for such an audit.

- Moreover, financial undertakings are already subject to very extensive product regulation, so that the implementation of the requirements from Art. 3 (g) of the Draft Directive would lead to a considerable operational and administrative effort as well as an additional cost burden. Against this background, the financial industry expects that the Draft Directive explain more specifically why regulated financial undertakings in particular should be included in value chain regulation.
- The list of services offered by a regulated financial undertaking to its customers, i.e. "*loan, credit and other financial services*" is also rather unspecific. It should be noted that the Draft Directive does not define the term "*other financial services*". This creates legal uncertainty, which should be avoided.

For the above-mentioned reasons, VAB is of the opinion that regulated financial undertakings should in general be excluded from the scope of the Draft Directive.