BlackRock

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RE: Proposal for a Directive on Corporate Sustainability Due Diligence

BlackRock[1] is pleased to have the opportunity to respond to the Proposal for a Directive on Corporate Sustainability Due Diligence. As an asset manager we would like to share some observations from the perspective of investing in companies on behalf of institutional and individual asset owners with long-term investment horizons.

We support the introduction of an EU-level framework which will facilitate a rigorous approach to value chain due diligence. This will help raise the bar and give interested parties (companies, shareholders and their other key stakeholders[2]) a common language with which to discuss environmental and human rights issues. To raise standards across the economy, it is important that the requirements are flexible enough to adapt to the specificities of different sectors to allow for effective management of value chain impacts and transparency to organisations' key stakeholders.

In our view, the way in which the framework is designed for the financial sector will be critical to its applicability and success. In particular, the framework should appropriately take into account differences between asset managers[3] investing on behalf of long term asset owners in companies and the companies themselves, with direct control over their own value chains. While asset managers can, and do, engage with companies on their management of human rights, environmental impacts and other issues in their value chains, responsibility for these business practices lies with the boards and the management of companies themselves. Expectations around due diligence must continue to recognize this, which is well articulated in the guidance for institutional investors published by the OECD in connection with its due diligence recommendations under the OECD Guidelines for Multinational Enterprises.

This guidance showcases the differing nature of feasible due diligence actions that can be undertaken by companies regarding their supply chains and those that can be undertaken by investors, or asset managers on investors' behalf, as part of the investment value chain. In this way, the OECD has sought to make its Guidelines (which apply to all industries and sectors) more relevant for institutional investors, recognizing that "the relationship between an investor and investee company is qualitatively different from the relationship between purchaser and supplier companies. In the former, there are no direct operational or contractual ties between the two, but the investor can seek to influence the investee through ownership."[4] Moreover the access to information is also different where there is no direct business relationship such as through a contract. Investors are legally expected to rely solely on public information which might not include all relevant information, due to confidentiality concerns.

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[1] BlackRock is one of the world's leading asset management firms. We manage assets on behalf of institutional and individual clients worldwide, across equity, fixed income, liquidity, real estate, alternatives, and multi-asset strategies. Our client base includes pension plans, endowments, foundations, charities, official institutions, insurers and other financial institutions, as well as individuals around the world.

[2] Including employees, suppliers, customers, communities, indigenous peoples and other interested parties

[3] Asset managers are hired by asset owners to invest assets on their behalf. As such, asset managers act as fiduciaries, which means acting in the best interests of the client and faithfully executing the investment mandate provided by the client.

[4] Responsible business conduct for institutional investors Key considerations for due diligence under the OECD Guidelines for Multinational Enterprise available https://mneguidelines.oecd.org/RBC-for-Institutional-Investors.pdf

The adoption of an equivalent approach within the Directive on Corporate Sustainability Due Diligence would also ensure that any requirements build constructively on existing practice in this area. As part of our fiduciary responsibility to our investment clients, we do engage with the management of the companies in our clients' portfolios, vote proxies for those clients who have given us voting authority and promote sound governance and responsible leadership as an informed, engaged shareholder. It is our conviction that our clients, as long-term shareholders, benefit when companies operate their businesses with a long-term purpose. In relation to adverse human rights issues, we believe unmanaged potential or actual adverse human rights issues can both harm the people directly affected, and expose companies to significant legal, regulatory, operational, and reputational risks. These risks can materialize in a variety of ways, from fines and litigation, to workforce and supply chain disruptions that may damage a company's standing with business partners, customers, and communities.

We identify companies for engagement based on our Engagement Priorities[5], our prior history of voting and engagement with the company, and our assessment of a company's management of material sustainability, or "ESG", factors inherent in their business models. We also consider events that have impacted or may impact long-term shareholder value, including breaches of international standards (such as the UN Guiding Principles for Human Rights / OECD Guidelines) that may result in adverse human rights impacts and create material business risks. In our company engagements we ask questions to understand how boards oversee management's approach to supply chain due diligence and assessment of impacts. Consistent with our published priorities[6], we encourage companies to report on their approach and how they assure themselves their policies and practices result in robust and responsible supply chains. Where we believe a company's approach should be enhanced to adequately manage risk, we may not support the re-election directors or other management proposals or vote in support of relevant shareholder proposals.[7]

In regard to environmental impacts, we support the Directive's proposed provision to have a plan ensuring business models are compatible with the transition to a sustainable economy. We do encourage companies to develop plans that are resilient under likely decarbonization pathways well below 2°C, as well as the growing global aspiration to limit warming to 1.5°C. Companies help investors understand their approach when they provide disclosures aligned with the four pillars of the TCFD—including GHG emissions, along with short-, medium-, and long-term science-based reduction targets, where available for their sector.[8]

We do not believe it would be appropriate for the Proposal to include financial products such as investment funds (which are often structured as companies under various national company law regimes) within the scope of the Directive as to do so would prevent the clear distinction needed between investors due diligence and corporate due diligence. Like investors, investment products do not have direct operational or contractual ties with underlying investee companies.

[5] BlackRock Investment stewardship engagement priorities, February 2022
https://www.blackrock.com/corporate/literature/publication/blk-stewardship-priorities-final.pdf
[6] BlackRock investment stewardship 2022 Policies update summary
https://www.blackrock.com/corporate/literature/fact-sheet/blk-responsible-investment-engprinciples-global-summary.pdf
[7] BlackRock Investment Stewardship Annual Report 2021
https://www.blackrock.com/corporate/literature/publication/annual-stewardship-report-2021.pdf
[8] BlackRock Investment Stewardship, February 2022 Climate risk and global energy transition
https://www.blackrock.com/corporate/literature/publication/blk-commentary-climate-risk-and-energy-transition.pdf

Recent regulatory changes at the EU level have created a specific set of rules about how various investment entities identify sustainability risks in their investment portfolios. The Sustainable Finance Disclosure Regulation (SFDR) contains requirements (where applicable) for product and entities relating to the principal adverse impacts of their investments. Changes to the Delegated Acts supporting the UCITS, AIFMD and MiFID frameworks require these regulated investors (and the individual investment funds they manage) to have an integrated process to identify sustainability risks in their investment and risk management governance and controls. These rules have created a framework through which asset managers' and investment funds' consideration of relevant issues is specifically regulated. Therefore, we would recommend that investment products and funds (UCITS, AIFs) be specifically exempted from the scope of this Proposal, so as not to capture them unintentionally and potentially impose requirements that conflict with other EU regulation.

In conclusion, we support the EU-level framework introducing requirements for companies to identify and, where necessary, prevent, end or mitigate adverse impacts of their activities on human rights, and on the environment. A sector-based approach to supply chain due diligence will be much more effective and meaningful for all stakeholders, including shareholders. Finally, we do believe a distinction needs to be made between the financial sector approach (especially as it relates to asset management) and all other sectors covered by the proposed Directive. Specifically, we believe an approach similar to the OECD's own approach in this area, establishing in particular a clear distinction between the investor due diligence guidelines and the broader supply chain guidelines is warranted.

We welcome further discussion on any of the points that we have raised.

Yours faithfully,

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