

The consequences of insurers' due diligence obligations for the real economy

Corporate Sustainability Due Diligence Directive (CSDDD)

General comments

The insurance industry supports the goals of a sustainable economy. However, **the insurance industry is concerned that the CSDDD could introduce obligations that would significantly complicate the provision of insurance coverage to companies.**

The Commission's draft and the European Parliament's position provide for the inclusion of customers (excluding SMEs, households and private individuals) in the value chain of insurers.¹ In this respect, the Council provides for a Member State option according to decide whether insurers have to apply due diligence obligations to customers.²

The inclusion of customers would mean that insurers **would have to apply CSDD obligations in particular to industrial and commercial companies in the real economy.** If obligations are not or insufficiently complied with, the insurer may face sanctions (Art. 20) and may be liable for damages (Art. 22; Art. 8c ("remediation")³).

The resulting legal risks would make the provision of insurance coverage considerably more difficult or even impossible. This applies to all types of insurance coverage and would particularly affect **occupational pension schemes and other insurance policies (including third-party protection).**

Due diligence obligations of insurers and consequences for the insured companies

Insurers would have to:

- **assess insured industrial and commercial companies** that do not fall under the SME exemption to determine whether their activities cause actual or potential negative impacts on human rights and/or the environment (Art. 6);

¹ Art. 3 lit. g CSDDD draft of the EU Commission and (with numerous differences in detail) the position of the European Parliament.

² Art. 3 lit. g in conjunction with Art. 2 para. 8 CSDDD-Council. In this case, according to the Council position, insured persons would also be included in addition to the policyholder himself.

³ Art. 8c CSDDD-EP or Art. 8 para. 3 lit. g CSDDD-Council.

- take adequate **measures to avoid or mitigate potential negative effects** and to remedy or minimize the extent of actual negative effects of the activities of the insured company (Art. 7 and Art. 8);
 - if an insurer cannot avoid, minimise or eliminate the negative effects, it would **not be allowed to enter into any new business relationships** according to the Commission's and Parliament's positions and would have to **terminate existing ones if necessary** (Art. 7 para. 5; Art. 8 para. 6). It is true that explicit exceptions are provided for financial companies (Art. 7 para. 6; Art. 8 para. 7). However, these are too **restrictive**. In this respect, the Council's position, that excludes a termination obligation for financial companies, is welcomed.
- It remains unclear how insurers can carry out the assessment of the activities of the insured companies regarding their actual and potential negative impacts on human rights and the environment in a practical and legally secure manner.
- There is a risk that insurers (can) no longer provide coverage to companies because they do not have the capacity to assess whether a risk exists or, in any case, cannot exclude such a risk.
- A rejection of insurance coverage would have extremely negative consequences for companies (e.g. in the case of the need for motor vehicle liability insurance), employees and, last but not least, victim protection, because injured parties (e.g. consumers, employees, etc.) would no longer be compensated by liability or accident insurance.

In addition to the above-mentioned consequences of implementing the CSDDD for companies and employees, the following characteristics must also be taken into account for **corporate pension and benefit schemes**:

- There is a broad consensus across Europe, and particularly in Germany, that occupational pension and benefit schemes should be spread and promoted because of their **sociopolitical importance**. This is reflected in the national regulation (e.g.: *Betriebsrentenstärkungsgesetz*) and in the current expert dialogue at the Federal Ministry of Labour and Social Affairs. According to this, obstacles with regard to the **dissemination of occupational pension and benefit schemes should be reduced**. If insurers had to apply the regulations of the CSDDD without exception, this would be contradictory to the sociopolitical idea of corporate pensions.
- For years, the German legislator has endeavored to take this sociopolitical idea into account; among other things, the **legal right to occupational pension schemes** (deferred compensation) was created for employees. **An insurer is required to implement this legal right**. Likewise, many German collective agreements provide for a mandatory provider (including an insurer) with whom the occupational pension scheme is to be carried out. If a contract with an insurer is not possible according to the specifications of the CSDDD, the companies are exposed to a **legal claim**

or collective agreement requirements that they cannot comply with. It must therefore be ensured that companies are still able to actually implement these legal requirements with an insurer, even under the provisions of the CSDDD. Especially since it can currently be observed that more and more companies are relying on the expertise and financial strength of an insurer for their occupational pension schemes (de-risking).

- The same applies to existing employment law commitments (*Zusage nach § 1a Betriebsrentengesetz*) that have been made in conjunction with an insurance company (business in force). If, according to the requirements of the CSDDD, an existing contract with an insurer had to be terminated, companies would be faced with the question of whether they could continue with the commitments made on occupational pension schemes at all. In this context, it must also be clarified whether a change to the commitment once given would be permissible under labor law with regard to the CSDDD (deterioration of the commitment).

The sociopolitical idea is also inherent in other employee benefits (e.g. company health insurance), so that **all employee benefits should be explicitly excluded from the scope** of application.

- The dimension and implications of these disadvantages for companies, employees, and consumers with regard to the business location and its **capacity to compete globally must be considered, analysed and carefully weighed** against the supportable goals of this directive.

Concrete examples

The following facts shall illustrate this by example:

1. The complaints against well-known German **automobile companies** and investigations by the Federal Office of Economics and Export Control (BAFA) due to alleged critical production conditions in China, which recently became known in the media, would raise the question whether these companies could be insured at all under the CSDDD. Since the draft directive does not require a causal connection between the service of the obligated insurer and the alleged violation of human rights by the respective companies, all existing and future insurance contracts would in principle be up for discussion, regardless of the business sector.

In this case, **can an insurer offer occupational pension coverage in the future without further ado?** Can the company be offered other insurance coverage in the future?

2. A **supra-regional bakery** (larger than an SME, e.g. with a total balance sheet of more than EUR 20 million and a net turnover of more than EUR 40 million) produces a full range of baked goods. For this purpose, it purchases about 100 different ingredients from changing traders, also from countries where it seems possible that children are also used for harvesting.

- To protect the climate and save energy costs, the company wants to install a large **photovoltaic system**. It would like to be insured against **damage caused by lightning, overvoltage and short circuits**. In the event that the system causes a fire and the fire spreads to neighbouring buildings, a **liability insurance** should be taken out. There are not enough financial reserves in the company to rebuild production facilities and warehouses or neighbouring buildings and apartment buildings that may have been destroyed by a fire.
 - A new production hall should be insured against **fire, natural hazards and technical damages**.
 - For the transport of the employees, the company organises a shuttle bus. This requires **motor vehicle insurance**.
 - The company wants to take advantage of functioning competition and change its business **liability insurer**. In particular, the liability insurance also covers damages to end customers (e.g. salmonella illness due to consumption of the baked goods).
 - An **accident insurance** should be taken out for the employees.
3. A large **agricultural company** (more than EUR 20 million in total balance sheet and more than EUR 40 million in net turnover) employs many foreign harvest workers. They receive a significantly lower wage than the other employees. The farm wants to take out **crop failure insurance and liability insurance** (which also covers the restoration of damage to the environment and biodiversity).
 4. The policyholder is a **GmbH (limited liability company) based in Germany** that manufactures and sells watches and jewellery and falls under the CSDDD due to its turnover and number of employees. The company has a co-insured subsidiary in South Africa which, among other things, mines diamonds. The German GmbH **declares in a writing to the insurer that the subsidiary complies with the human rights and environmental protection** conventions in accordance with the Annex to the CSDDD. **Can the insurer continue to insure this policyholder?** In these cases, it is also essential to know for insurers when they have fulfilled their obligation to assess.

More generally: How should insurers deal with insured companies where negative impacts within the meaning of the CSDDD are either known or suspected, or cannot be ruled out with economically justifiable effort? Should all insurance coverage be denied – including coverage that does not serve the company itself, but rather the employees ("occupational pension plan"; "accident insurance") or the protection of damaged third parties ("business liability insurance"; "motor vehicle liability insurance") or, in the case of environmental damage, covers clean-up costs ("environmental damage insurance")?

Conclusions

The possible negative backlash on the insurance coverage of companies should be taken into account and avoided. What seems necessary is a limitation of the obligation and liability of insurers in several respects:

- Insurance policies in the context of **corporate pension and benefits** should be explicitly **excluded** from the scope of application. CSDDD risks of the insured company and occupational pension schemes for its employees are not sufficiently interrelated to justify their inclusion.
- Moreover, **mandatory insurance products and other insurances that also benefit injured third parties or the employees of companies**, i.e. in particular compulsory insurance, liability insurance, accident insurance, should be **excluded** from the scope of the Directive. The purpose of these insurances, which also serve to protect employees and victims, must also be taken into account.
- **In any case, graduated due diligence obligations** should apply to insurers. A causal connection between the respective insurance coverage of the companies (which e.g. serves the protection of employees or the protection of victims) and the (potentially) negative effects of the activities of the insured company is generally not evident. This should be taken into account – as basically intended by the European Parliament – in the design of the obligations. Insurers should be allowed to rely in particular on **contractual assurances and certificates**, which should be explicitly regulated.
- It should be made clear (following the Council position) **that insurers are not obliged to refuse or terminate insurance coverage**.
- **A separate civil-law liability for compensation (Art. 22; 8c) of insurers for damage caused by third parties, such as insured companies, should be excluded**. However, the parliamentary position which aims at this still needs further clarification for this purpose. From the point of view of liability insurance in particular, it is essential that the requirements for the civil liability of obligated policyholders are designed to be fault-based and causation-based as well as legally secure in order to be able to assess and price the insurance risk.



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Berlin / Brussels, 12th July, 2023

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ID-Number 6437280268-55
