30 September 2020

Consultation on the EC Impact Assessment on Sustainable Corporate Governance - ecoDa's Response -

Initial remarks:

Given that the EC Impact Assessment on Sustainable CG is largely based on the EY related survey, ecoDa will largely focus its comments on this report.

ecoDa strongly believes in the importance for companies and directors to strengthen their long-term strategies by further integrating the interests of legitimate stakeholders that make sense to their business. Boards have a duty to be clear in their strategic choices and must be able to justify them in the light of external constraints which can turn out to be sources of formidable opportunities. The Commission's desire to support this change is legitimate. Corporate Governance codes, which have the advantage of being flexible and quickly adapted, have already taken into account those considerations. The same applies to the institutes of directors who have made ESG and sustainability topics a long-standing priority and who engage their members in reflection and action.

It is important to understand the changes taking place on the ground and to avoid conveying preconceived ideas. It is in a constructive and positive approach that the legislators, the administrators, and also the investors must engage. Successful companies are those which have placed clients at the heart of their product strategy or which have integrated a real quality approach into the value chain of their services. The directors have understood that they must put energy efficiency or reducing the carbon footprint, but also the respect for human and social rights at the heart of their business model. It is also thanks to companies that innovations protecting the environment occur. ecoDa does not find the EY report to be true to reality in this respect. We explain why in our comments under the headline "Regarding the findings" below.

ecoDa is also concerned about the legal excesses suggested in the report which would weaken European companies and the principles of directors' liability, as well as the negative vision the Commission relays on businesses which does not reflect all efforts undertaken by companies to integrate sustainability in their strategies. If the proposals in the report are *fully implemented, it will have devastating effects on the efficiency, innovativeness and competitiveness of European companies – and hence on the EU economy at large.*

1. Regarding the findings:

- Fragility of the report:
    - The report itself shows dissatisfaction with the results obtained during their study. ecoDa had drawn attention to the inadequacy of the survey which proved to be far too long to complete. In addition, the survey focused less on real facts to understand the evolution of practices than on feelings or aspirations. All elements contributed to the lack of appetite to respond.
    - The report is a compilation of mostly already existing literature – the choice of which appears surely biased towards the preconceived outcomes. Moreover, the survey and the interviews do not provide real quantitative, nor qualitative inputs. Almost no reference is made to the responses received.
    - The report does not attempt to describe precisely the reality of boards of directors.
- The report is simplistic and biased:
    - The report does not sufficiently emphasize the importance of fairly compensating shareholders and the fact that companies cannot exist without them, especially in times of crisis when companies are in acute need of equity funding. Furthermore, the report does not take the risks of ownership into account.
    - From an individual company point of view, there is a lot of other considerations conceivably underlying dividend decisions. In a modern market economy, most of the capital paid out to shareholders of listed companies is in fact re-invested as business risk capital in new and dynamic companies.
    - The report does not provide a detailed analysis of the legal obligations or those set out in the corporate governance codes which apply to the directors as well as all the developments resulting from judicial decisions.
    - The report seems to consider that there is only one single model of governance (UK CG model with dispersed ownership) and does not sufficiently take into account the diversity of systems existing across Europe. Most of EU market is characterized by more concentrated ownership.
    - The diffuse shareholder model has been made necessary for the financing of real assets. With the new economy, there is no longer a need for such investments. The proportion of intangible assets is higher. With the example of Facebook, new companies are now run by majority shareholders. The paradigm of the agent conflict, which aimed to resolve the potential conflict between the manager and the dispersed shareholders, is changing. It is now more a question of resolving the conflict between majority shareholders and minority shareholders.

    - The report focuses on the directors' duties without putting the question of their accountability in parallel.
    - The report is also unclear on what it is meant by « corporate governance committees » while referring to some respondents to the survey.
- In general, the report gives the impression of serving as a fallback to already pre-established conclusions.

2. Regarding the solutions:

- Driver 1 – *Directors' duties and company's interest are interpreted narrowly and tend to favour the short-term maximisation of shareholders' value:*
    - ecoDa would like to point out false assumptions like: *« In addition, the national regulatory frameworks in the 12 Member States tend to link the concept of directors' duties and company's interest with short-term objectives»*. Quite the contrary – the aim for long-term success of the company – is embedded in the legislation of some Member States.
    - ecoDa may see an interest in a recommendation specifying directors' duties at least to put an end to the myth in collective unconsciousness that they would only favour the interests of the shareholders.
    - ecoDa believes in the value of example and encourages the Commission to develop guidance to help board members integrate sustainability aspects (impacts, risks, opportunities) into the business strategy and set adequate sustainability targets aligned with overarching goals, strengthening responsibility for sustainable value creation. The members of ecoDa are at the disposal of the Commission for this exercise.

- Driver 2 – *Growing pressures from investors with a short-term horizon contribute to increasing boards' focus on short-term financial returns to shareholders at the expense of long-term value creation :*
    - In general, the Commission should refrain from reforming legislative texts whose adoption remains recent (Cf. Shareholders Rights Directive). The credibility of the European legislative system and the bureaucratic overload for companies are at stake (*« Unnecessary laws weaken necessary laws » - Montesquieu)*.
    - The European Commission tends to generalize investors with a short-term horizon while many investors make sustainability the new standard for investing.

- Driver 3 – *Companies lack a strategic perspective over sustainability and current practices fail to effectively identify and manage relevant sustainability risks and impacts.*

  - The survey lacks a common definition of what is meant by sustainability. This can vary from one sector to another.

- Driver 4 – *Board remuneration structures incentivise the focus on short-term shareholder value rather than long-term value creation for the company*
  - ecoDa does not understand why the subject of remuneration is put back on the table when the European Commission has still not published its guidance on remuneration report (providing that the EC intends to finalize this project), nor why it ignores the widely observed trend to favour long-term incentives (LTI) as a key component of executive remuneration.
  - The statement is not based on facts. The situation regarding the links of remuneration and sustainability issues is rapidly changing. In fact, when 12 per cent of S&P500 companies had ESG criteria in their remuneration criteria, in 2013 already 37 per cent of them used ESG criteria. It is evident, that the ratio has risen sharply since then.
  - Besides, board remuneration usually built on fixed fees. Executive directors may have variable remuneration.

- Driver 5 – *The current board composition does not fully support a shift towards sustainability.*
  - It does not make any sense to require competences in sustainability issues. Here again, sustainability can have different meanings.
  - ecoDa questions the feasibility of a recommendation that would request Member States « to ensure that sustainability-related expertise is systematically considered in the board nomination process of companies (M5.2) ». Legislative acts require a minimum of clarity, and yet another compulsory requirement as contemplated here could only result in a sterile box-ticking exercise.

    This is the reason why in none of the 12 EU Member States (in scope of this study), any legal provisions that require the board to be composed of directors with sustainability expertise can be found.
  - For natural reasons the legislator does not and should not define the competence of directors. Acceptable exceptions may relate to the financial sector and some audit committee members. The situation of a company changes over time, at the same time the required competence of the board members changes.

- Driver 6 – *Current corporate governance frameworks and practices do not sufficiently voice the long-term interests of stakeholders*
  - The establishment of a Commission Advisory Group on Sustainable Corporate Governance to identify good practices on stakeholder engagement and involvement could make sense as long as the differences in terms of CG models are taken into consideration.

    - It should be recalled that current law and practice in many European countries does give a wider access to stakeholders (especially employees) to corporate governance.

- Driver 7 – *Enforcement of directors' duty to act in the long-term interest of company is limited*
    - ecoDa would like to question this assumption: « If EU were not to act, current enforcement levels of directors' duty of care in Member States can be expected to remain low, in line with the existing trend ».
    - Contrary to what the report states, there are cases of enforcement. This can be discovered with fact finding from insurers. There are not infrequently cases where directors liability is enforced.
    - The report states that: « there are neither provisions of company law nor self-regulatory measures which expressly allow the stakeholders of a company to instigate legal proceedings <u>on behalf of the company</u> to sue its directors for not having taken the stakeholder interests into account as part of their duty of care». ecoDa wishes to warn about the excesses of such provisions. There is a great risk of diluting the energy of the directors in endless lawsuits where each stakeholder who feels aggrieved by a decision could take legal action. Stakeholders have diverging interests, and the role of boards of directors is largely a balancing act to arbitrate between these. The European Commission should think twice before changing the accountability rules. Such provisions would clearly lead to the creation of risk-averse companies in Europe.

As a general principle, ecoDa would like to repeat that taking into account all stakeholders' interests on an equal footing should not be the ultimate goal of companies. Stakeholders' interests are often contradictory between themselves: to take the simplest example, the interest of customers is that prices are as low as possible, the interest of the company's suppliers and workforce is that they are as high as possible so as to soften cost-cutting. Boards should not be turned into bargaining bodies where different, often probably mutually conflicting interests are turned against each other, thus hampering efficient decision-making. However, responsible boards must definitely arbitrate between the interests they take into regard and those they ignore. Boards should take into account the interests of both shareholders and the relevant stakeholders of the company which need to be clearly identified and can be specific to certain sectors and companies.

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About the European Confederation of Directors Associations:

The European Confederation of Directors Associations (ecoDa) is a not-for-profit association founded in December 2004 under the laws of Belgium. Through its 20 national institutes of directors (the main national institutes existing in Europe), ecoDa represents approximately 55,000 board directors from across the EU. ecoDa's member organizations represent board directors from the largest public companies to the smallest private firms, both listed and unlisted.

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