

14 July 2020

ecoda's Response

The Consultation on the Renewed Sustainable Finance Strategy

To reflect long-term opportunities and risks, such as those connected to climate change and environmental degradation, companies and investors need to integrate long-term horizons and sustainability in their decision-making processes. However, this is often difficult in a context where market pressure and prevailing corporate culture prompt corporate managers and financial market participants to focus on near-term financial performance at the expense of mid- to long-term objectives. Focusing on short-term returns without accounting for long-term implications may lead to underperformance of the corporation and investors in the long-term, and, by extension, of the economy as a whole. In this context, investors should be driving long-termism, where this is relevant, and not pressure companies to deliver short-term returns by default.

The ongoing COVID-19 outbreak in particular underscores that companies should prioritise the long term interests of their stakeholders. Many companies in the EU have decided to prioritise the interests of key stakeholders, in particular employees, customers and suppliers, over short-term shareholder interest. These factors contribute to driving long-term returns as they are crucial in order to maintain companies' ability to operate. Therefore, institutional investors have an important role to play in this context. As part of action 10 of the Action Plan on Financing Sustainable Growth, in December 2019 the European Supervisory Authorities delivered reports (ESMA report, EBA report, EIOPA report) that had the objective of assessing evidence of undue short-term pressure from the financial sector on corporations. They identified areas within their remit where they found some degree of short-termism and issued policy recommendations accordingly. For instance, they advise the adoption of longer-term perspectives among financial institutions through more explicit legal provisions on sustainability.

Question 38: In your view, which recommendation(s) made in the ESAs' reports have the highest potential to effectively tackle short-termism? Please select among the following options. Adopt more explicit legal provisions on sustainability for credit institutions, in particular related to governance and risk management; Define clear objectives on portfolio turn-over ratios and holdings periods for institutional investors; Require Member States to have an independent monitoring framework to ensure the quality of information disclosed in remuneration reports published by listed companies and funds (UCITS management companies and AIFMs); Other, please specify. [box max. 2000 characters]

- ecoDa does not favour any of the predefined options since we consider them unduly far-reaching and prescriptive. ecoDa would rather propose comply-and-explain-based code regulation.

Question 39: Beyond the recommendations issued by the ESAs, do you see any barriers in the EU regulatory framework that prevent long-termism and/or do you see scope for further actions that could foster long-termism in financial markets and the way corporates operate? Yes/No/Do not know. If yes, please explain what action(s). [BOX max. 2000 characters]

- ecoDa believes that the regulator should abstain from trying to force institutional investors to act in ways not consistent with their purpose to promote the interests of their beneficiaries. Certainly, the interests of the beneficiaries of many institutional investors are indeed quite long-term (such as those of pension funds), but this does not necessarily make the institutional investor a long-term owner of its investee companies. In fact, in order to protect the long-term interest of its beneficiaries an institutional investor must at all times be prepared to - short-term - disinvest in some of its investee companies. In addition to this, the sheer « free-rider problem » generally makes it difficult for a single institutional investor, owning perhaps 5-10 percent of a company, to motivate spending the time and money necessary to act as a truly long-term and engaged company owner.

For these reasons, ecoDa would invite the regulator to rather try to facilitate investor coalitions that could function as vehicles for exerting a more engaged and long-term ownership role. A good example is the Investor Forum which was established in the UK following the findings of the Kay Review of UK equity markets and long-term decision-making which recommended that a body be established to facilitate collective engagements by UK investors in UK companies. The Forum's members now represent about 1/3 of the FTSE All Share's market capitalisation. Such coalitions mean for boards that they do not become overwhelmed by similar requests from multiple investors.

However, making investor coalitions of this kind workable in practice would probably require to alleviate present barriers to "acting in concert". In fact, a step in this direction was taken some years ago when ESMA published a white list of possible forms of investor co-operation without violating the Mandatory Bid Rule. ecoDa thinks that a review of this list with the aim to widen it, possibly in combination with the raising of the current 30% limit triggering a mandatory bid, might be worth looking at.

The Shareholder Rights Directive II states that directors' variable remuneration should be based on both financial and non-financial performance, where applicable. However, there is currently no requirement regarding what the fraction of variable remuneration should be linked to, when it comes to non-financial performance.

Question 40: In your view, should there be a mandatory share of variable remuneration linked to non-financial performance for corporates and financial institutions? Yes/No/Do not know. If yes, please indicate what share. [box 2000 characters]

- No - While we support the application of non-financial remuneration criteria, ecoDa would not support a mandatory share of variable remuneration linked to non-financial performance, as we don't see how it could be calculated across all the different sectors and companies. Hence this matter should be left to the board and/or shareholders (depending on who sets the remuneration concerned) of the individual company to determine. The current crisis shows how quickly a company's situation may change. It could prove dangerous to tie companies to inflexible remuneration schemes and not allow companies to fully adjust their remuneration policies when needed.

Question 41: Do you think that a defined set of EU companies should be required to include carbon emission reductions, where applicable, in their lists of ESG factors affecting directors' variable remuneration? Yes/No/Do not know.

- No- For the same reason explained under question 40, ecoDa would not support such a prescriptive measure.

The Shareholder Rights Directive II introduces transparency requirements to better align long-term interests between institutional investors and their asset managers.

Question 42: Beyond the Shareholder Rights Directive II, do you think that EU action would be necessary to further enhance long-term engagement between investors and their investee companies? Yes/No/Do not know.

- Yes, ecoDa would be in favour of EU guidelines to enhance long-term engagement between investors and their investee companies (see the ideas put forth under Q39) ;

Question 43: Do you think voting frameworks across the EU should be further harmonised at EU level to facilitate shareholder engagement and votes on ESG issues? Yes/No/Do not know

- ecoDa does not believe that harmonizing voting frameworks would solve the problems of shareholder engagement. Not all institutional investors have the resources to analyze all the data provided at AGMs. In addition, the regulator should not force equalization of voting procedures at AGMs. Existing differences in this respect pose no threat to shareholder engagement or voting on ESG issues.

Question 44: Do you think that EU action is necessary to allow investors to vote on a company's environmental and social strategies or performance? Yes/No/Do not know. If yes, please explain. [BOX max. 2000 characters]

- ecoDa does not understand the rationale behind this question. Shareholders always have the final say companies' strategy at large, through various ways (approval of accounts, capital variations, appointment and dismissal of directors etc.), and that includes ESG matters. Facilitating for owners to raise issues for a vote at the AGM regarding ESG and other pertinent matters would in many member states most likely contribute to increased shareholder

engagement in a more long-term perspective. However, in most jurisdictions, a small minority of shareholder(s) can always have issues including ESG matters included in the AGM agenda. Making a distinction between ESG matters and others may prove to be the subject of unnecessary disputes.

Questions have been raised about whether passive index investing could lower the incentives to participate in corporate governance matters or engage with companies regarding their long term strategies.

Question 45: Do you think that passive index investing, if it does not take into account ESG factors, could have an impact on the interests of long-term shareholders? Yes/No/Do not know. If no, please explain the reasons for your answer if necessary. [BOX max. 2000 characters] If yes, in your view, what do you think this impact is, do you think that the EU should address it and how? [box max. 2000 characters]

- Yes, in a positive way. Investors that do not integrate ESG into their investment decisions facilitate for those who do to earn a better return. This is, however, not unique for passive index investments. It is also possible to invest passively using ESG-customized indices. This is becoming more common.

To foster more sustainable corporate governance, as part of action 10 of the 2018 Action Plan on Financing Sustainable Growth, the Commission launched a study on due diligence (i.e. identification and mitigation of adverse social and environmental impact in a company's own operations and supply chain), which was published in February 2020. This study indicated the need for policy intervention, a conclusion which was supported by both multinational companies and NGOs. Another study on directors' duties and possible sustainability targets will be finalised in Q2 2020.

Question 46: Due regard for a range of 'stakeholder interests', such as the interests of employees, customers, etc., has long been a social expectation vis-a-vis companies. In recent years, the number of such interests have expanded to include issues such as human rights violations, environmental pollution and climate change. Do you think companies and their directors should take account of these interests in corporate decisions alongside financial interests of shareholders, beyond what is currently required by EU law? Yes, a more holistic approach should favour the maximisation of social, environmental, as well as economic/financial performance. Yes, as these issues are relevant to the financial performance of the company in the long term. No, companies and their directors should not take account of these sorts of interests. I do not know.

- Option 1 - Due regard of (relevant) stakeholder interests is certainly of great relevance to the long-term performance of the company. In some jurisdictions, new company law allows companies to define a secondary social purpose alongside profit for shareholders. Actually companies and their directors already take account of these interests in corporate decisions alongside financial interests of shareholders, beyond what is currently required by EU law. It is important to understand that legislation does not provide the maximum framework for companies and their directors for their actions. Companies and their directors take a holistic view of the current and future circumstances and values of their stakeholders such as

customers and employees in order to be successful in the markets, whether for their products or as employer.

Question 47: Do you think that an EU framework for supply chain due diligence related to human rights and environmental issues should be developed to ensure a harmonised level-playing field, given the uneven development of national due diligence initiatives? Yes/No/Do not know.

- No – ecoDa could support minimum standards but the feasibility is questionable given the variety of maturity levels in Europe.

Question 48: Do you think that such a supply chain due diligence requirement should apply to all companies, including small and medium sized companies? Yes/No/Do not know. If yes, please select your preferred option: All companies, including SMEs. All companies, but with lighter minimum requirements for SMEs. Only large companies in general, and SMEs in the most risky economic sectors sustainability-wise. Only large companies. If necessary, please explain the reasons for your answer. [box max. 2000 characters]

- Only large companies in general - The administrative and cost burden can generally be absorbed by large groups (either listed or non-listed) but not so by SMEs and VSEs whose competitiveness might suffer and be unable to cope with generic standard obligations.