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ShareAction's feedback to the European Commission's Inception Impact Assessment on Sustainable Corporate Governance

ShareAction, the responsible investment advocacy group, welcomes the opportunity to provide feedback on the Inception Impact Assessment on sustainable corporate governance. We strongly support the Commission's efforts to effectively raise the bar on corporate transparency with an ambitious review of the Non-Financial Reporting Directive that should allow responsible investors to drive sustainable corporate change through stewardship and engagement. This is also why we have called for the introduction of a Stewardship Code at EU-level.

However, the European Supervisory Authorities' reports from 2019 demonstrate the short-term pressures that financial markets exercise on corporates. Hence, alongside explicitly integrating sustainability issues in investor duties, a successful transition towards an economy with business models and corporate behaviour that limit impacts on the environment and communities also requires an adequate EU regulatory framework on company law and corporate governance. The Commission study on directors' duties and sustainable corporate governance once again shows a pervasive short-termistic tendency among listed companies within the EU, highlighting a clear upward trend in corporate pay-outs to shareholders compared to revenues vis-à-vis a declining ratio of investment to revenues.

Last June, alongside 44 other NGOs we have congratulated Commissioner Reynders on publicly committing to legislating on sustainable corporate governance in 2021 addressing both mandatory corporate due diligence and directors' duties.[1] Appreciating existing Member State legislation on sustainable corporate governance as well as announced initiatives in this field, ShareAction agrees with the Commission's assessment in the subsidiarity check that national intervention is likely to result in market fragmentation and potentially in regulatory arbitrage, and thus supports an initiative at EU-level that amends the Company Law Directive (2017/1132) and the consolidated Directive on Shareholder rights (2007/36).

We strongly support the introduction of a requirement for companies "not to do harm" and to empower corporate directors to integrate wider societal interests, in line with Action 10 (ii) of the Sustainable Finance Action Plan on the "possible need to clarify the rules according to which directors are expected to act in the company's long-term interest".

The UK's "Duty to promote the success of the company" as set out in Section 172 of the *Companies Act 2006*[2] introducing a long-term approach, stakeholders' interests as well as the company's impact on the community and the environment, has been criticized for being unfit for purpose, given that it is very difficult to hold directors liable under this provision. It is thus essential that the Commission's initiative operationalizes such a definition by requiring companies to integrate sustainability issues in their corporate policies, strategies and KPIs (and requiring them to report on progress against them, ideally with measurable and time-bound science-based targets).

[1] https://shareaction.org/wp-content/uploads/2020/06/Joint-CSO-letter-to-Commissioner-Reynders-on-corporate-governance_23June2020_final.pdf
[2] https://www.legislation.gov.uk/ukpga/2006/46/section/172

To reduce distortions and incentives to act in a short-termistic way, the proposed initiative should review executive remuneration for it to also be linked to longer-term sustainability targets amending the Shareholder Rights Directive II. In this context, it would be appropriate to examine policy options with regards to stock options and other stock-based components of executive compensation packages and how these might distort incentives from investing in the company's growth as opposed to boosting stock-prices e.g. through share buy-backs.

An expanded definition of directors' duty of care needs to be complemented with the necessary enforcement and implementation mechanisms against a backdrop of ever-decreasing direct ownership, short share-holding periods and issues with the exercise of voting rights.

As adverse impacts are not limited to companies' direct operations, and often significant influence is exercised over their suppliers, it is crucial that alongside a clarification of directors' duties an effective mandatory due diligence framework is put in place. This should be based on existing practice such as the OECD Due Diligence Guidance for Responsible Business Conduct. Consumers, savers and retail investors should have the confidence that products, services or financial products do not cause human rights abuses and environmental damage.

The Workforce Disclosure Initiative has found for instance that while companies generally have in place policy-level commitments on responsible sourcing and supply chain workers' rights they are less able to provide data on how these commitments are implemented.[3] This is also confirmed by the findings of the Alliance for Corporate Transparency.[4] ShareAction is confident that an ambitious review of the Non-Financial Reporting Directive with an emphasis on supply-chain transparency is necessary to reinforce the links between sustainable corporate governance and corporate transparency.

About ShareAction

ShareAction is a non-profit working to build a global investment sector which is responsible for its impacts on people and planet. We mobilise investors to take action to improve labour standards, tackle the climate crisis, and address pressing global health issues, such as childhood obesity. Over the last 15 years, ShareAction has used its powerful toolkit of research, corporate campaigns, policy advocacy and public mobilisation to drive responsibility into the heart of mainstream investment. We want a future where all finance powers social progress.

ShareAction's EU policy engagement focuses on supporting the development of an effective regulatory framework of sustainable finance and long-term investment that ensures the interests of end-investors are heard and the financial sector helps deliver on ambitious environmental and social goals.

Visit shareaction.org or follow us @ShareAction on Twitter to find out more.

[3] https://shareaction.org/workforce-disclosure-initiative/why-disclose-to-the-wdi/wdi-2019-findings/
[4] http://www.allianceforcorporatetransparency.org/