BETTER FINANCE
The European Federation of Investors and Financial Services Users
Fédération Européenne des Épargnants et Usagers des Services Financiers

Ref: Sustainable Corporate Governance

Link to consultation: https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12548-Sustainable-corporate-governance

BETTER FINANCE's feedback on Sustainable Corporate Governance

(inception impact assessment for an EU directive proposal)

About BETTER FINANCE

BETTER FINANCE, the European Federation of Investors and Financial Services Users, is the European public interest non-governmental organization solely dedicated to the interests of European citizens as savers, individual investors and financial services users at the European level to lawmakers and the public in order to promote research, information and training on investments, savings and personal finances.

BETTER FINANCE acts as an independent financial expertise and advocacy center to the direct benefit of European financial services users. Since the BETTER FINANCE constituency includes individual and small shareholders, fund and retail investors, savers, pension fund participants, life insurance policy holders, borrowers, and other stakeholders who are independent from the financial industry, it has the best interests of all European citizens at heart. As such its activities are supported by the European Union since 2012.

Introduction

The initiative[1] wants to ensure that sustainability is further embedded into the corporate governance framework with a view to align better the long-term interests of management, shareholders, stakeholders and society. And intends to provide pursue the following objectives:

- *Help companies' directors to establish longer-term time horizons in corporate decision-making;*
- *Withstand short-term pressures;*
- *Strengthen the resilience and long-term performance of companies through sustainable business models;*
- *Create legal certainty and level playing field to identify, assess and mitigate adverse impacts in the value chain.*

[1] *"The exact type of initiative should be identified based on the impact assessment. It could include modifying the codified company law Directive (2017/1132) and the consolidated Directive on Shareholder rights (2007/36)."*

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Regarding company directors the initiative wants to:

- *Companies to take measures to address their adverse sustainability impacts, such as climate change, environmental, human rights*
- *Company directors to take into account all stakeholders' interests which are relevant for the long-term sustainability of the firm or which belong to those affected by it (employees, environment, other stakeholders affected by the business, etc.), as part of their duty of care to promote the interests of the company.*
- *An appropriate facilitating, enforcement and implementation mechanism accompanying these duties, including possible remediation where necessary;*
- *Other possible corporate governance arrangements for example regarding directors remuneration.*

BETTER FINANCE Recommendations

BETTER FINANCE warmly welcomes the European Commission initiative to improve the EU regulatory framework on company law and corporate governance. We consider that it has become imperative to reinforce the link between long-term value creation and sustainability. Notably, sustainable investments that contributes to environmental, social and governance (ESG) objectives require long-term orientation. Nonetheless, sustainability is facing several issues related to **market pressure and corporate culture that tends to focus on short-term performance at the expenses of long-term objectives.**

Therefore, BETTER FINANCE would like to propose the following policy recommendations to promote long-term value creation and sustainability:

- **Oversight of boards**: Supervisory boards/(non-executives on the) boards of directors oversee the performance/strategy of management. It is crucial and considered as good governance that members of the boards are knowledgeable, diverse, independent (sufficient number of independent members) and not overly burdened with other mandates (so called overboarding). The supervisory board members/non-executive BoD members representing shareholders are appointed by the general meeting, therefore the nomination process should be transparent for shareholders and in advance of the vote for the election of a board member.

- **The auditor of a company should likewise be independent**. A regular audit rotation and transparency of the audit tender process is part of good governance. In addition, there should be a separation of non-audit and audit services. Also, given the Wirecard case, there is the need for a greater emphasis on forensic accounting (in order to detect fraud). The liability cap at auditors, for example in Germany, is currently restricted to 4 million EUR and only in case of deliberate intention. This cap needs to be lifted and extended to gross negligence.

- **Increased dialogue between investors and issuers is necessary to hold the boards' to account.** They have to explain their actions and reconsider certain action if the majority of their owners is not in favour. A first step in that direction has been done by SRD II which requires boards to reassess a remuneration system for executive directors in case of significant shareholder opposition and to report back to the general meeting afterwards. The problem is that direct ownership is more and more decreasing while indirect ownership via funds or ETFs is increasing. This intermediated ownership has led to a lack of oversight as many "institutional investors" (asset managers) do not (fully) exercise the voting rights of the shares they hold in their portfolios. SRD II only requires transparency on how institutional investors engage. They should be required to engage and to exercise the voting rights. Individual investors – who usually have a longer term horizon - should also be enabled to exercise their voting rights, in particular cross-border within the EU , as highlighted by the High Level Forum on the CMU (HLF CMU) in its report and recommendations of June 2020[2], which should be taken on board by the EC. An EU-wide definition of "shareholder" is required to avoid having international financial intermediaries vote in place of the actual shareholders of EU listed companies.

- **Better engagement:** Institutional shareholders have the largest impact on corporate governance as the former manage billions of euros of capital on behalf of EU citizens. However, asset managers have little incentive – and put little effort – to actively engage with investee companies and far too often change ownership (buy and sell) in companies: the annual turnover rate of "active" asset managers' portfolios is on average above 100%, which means that on average they hold a given share for less than one year The EU Commission should consider developing a **stewardship code** – a framework of duties that asset managers must observe with regards to the issuers. In addition, institutional investors should be obliged to produce reports justifying why their actions in corporate governance of companies best serve the company and their clients (beneficial owners).

- **Remuneration caps**: BETTER FINANCE acknowledges the existence of disproportionate remuneration of some directors in some of the big listed EU companies. For this reason, we consider that the establishment of renumeration caps for directors is necessary. The maximum remuneration should be adopted for base salaries and as well for variable remunerations. In addition, we consider it necessary that the guidelines on remuneration of directors (SRD II) are being put in place as soon as possible to provide investors with more standardised, more harmonised and more transparent information about directors' pay across Europe.

- **Promote and incentivize Employee Share Ownership (ESO)** throughout the EU to increase the resilience of businesses and reduce employment-fluctuation in times of

[2] https://ec.europa.eu/info/sites/info/files/business_economy_euro/growth_and_investment/documents/200610-cmu-high-level-forum-final-report_en.pdf

economic crisis. This is also a key recommendation from the HLF CMU. ESO leads to an increased long-term engagement of employee shareholders with a stronger focus on sustainability and improving the corporate governance of the companies they are invested in, since employee-owned companies tend towards increased responsibility and hold their immediate environment in higher regard, because they internalise the externalities. ESO also has a pivotal and positive role to play in corporate governance matters, and should be part of any push by EU authorities to further embed sustainability into the corporate governance framework, as many companies still focus too much on short-term financial performance compared to their long-term development and sustainability aspects.

- **Harmonised non-financial reporting:** For shareholders and issuers likewise it is important that definitions of non-financial (performance) indicators are harmonised throughout different pieces of legislation, to allow for comparability.

- **A clear definition of the terms "short-termism" and "long-term shareholder engagement"** would be helpful to understand what the Commission considers as being a wishful shareholder engagement/management of a company. In addition, we question the relation that is being made in the study between dividend payments and short-termism at company level. The study on directors' duties and sustainable corporate governance [3] in this respect disregards that dividend payments are not "lost money" but primarily a risk premium for the owners and may likewise be reinvested in other (maybe even more sustainably acting) companies.

- Regardless of the fact that society as a whole has a rightful great interest in the sustainable development of (listed) companies, caution is required when interfering with company law, especially with the rights of shareholders as owners of companies and with those of directors (executive and non-executive) in setting targets and in taking business decisions.

[3] file:///C:/Users/User/Downloads/DS0320415ENN.en%20(3).pdf