Ref: Consultation on Sustainable Corporate Governance

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

BETTER FINANCE Response

Executive Summary

Need and objectives for EU intervention on sustainable corporate governance

BETTER FINANCE considers noteworthy the aim of the EC Commission to establish a European framework on Sustainable Corporate governance in order to better hold directors accountable to long-term oriented stakeholders. However, BETTER FINANCE warns against basing any future measures on the conclusions of a *Study on directors' duties and sustainable corporate governance*[1] due to its methodological flaws and misleading interpretation of the shareholder's roles:

- Lack of representativeness: Key players in the European capital markets representing EU citizens such as BETTER FINANCE, the only EU-level organization representing altogether more than 4.5 million of individual investors and DSW, the no.1 association for private investors in Germany with more than 30.000 members, were not even invited to take part in this study.
- Wrong view of shareholders and therefore the study offers the wrong conclusions. The concept of "*primacy of shareholders' interests" and* shareholders' "short-termism", is certainly wrong in the case of individual shareholders.
- Lack of transparency as regards information about companies that had been analysed in the study. Also, it is **important to differentiate between different kinds of companies**: those from traditional industries with rather low growth rates.
- Lack of proper differentiation among different kinds of shareholders, among them "institutional" professional "investors" (better characterized as "agency owners") and private shareholders with different horizons and risks/rewards of their investments.

Furthermore, the outcome of important EU legislation (Taxonomy Regulation and the Non-Financial Reporting Directive) should be awaited before intervening deeply into national company laws and in order to avoid overregulation.

We believe the EC is very right to address the issue of sustainable corporate governance. It should focus on lowering the barriers to the long-term engagement from the end-investors, i.e. the EU citizens as individual investors and long term and pension savers. They are indeed the ones bearing most of the risks (and parts of the rewards) of share ownership, either as direct or as indirect investors. Otherwise, sustainable value for money and pension adequacy will be harder to reach.

[1] Study on directors' duties and sustainable corporate governance https://op.europa.eu/en/publication-detail/-/publication/e47928a2-d20b-11ea-adf7-01aa75ed71a1/language-en

Directors' duty of care – stakeholders' interests	Board of directors should find the right balance between the interests of their employees and the high priority interest of their customers and ensure that the shareholders are adequately represented. Regardless of the fact that society as a whole has a rightful 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. Better and sustainable governance is more to be improved by ensuring "**agency owners**" like pension and investment funds and unit-linked insurers (who all legally "own" the shares of EU companies, but actually transfer all of the investment risks and part of the rewards to their individual clients) have the adequate governance to enable those clients to engage as indirect owners. We underline that referring to "*short-term financial interests of shareholders*" is highly questionable, ignores individual shareholders, and fails to consider differences among shareholders. **EU citizens as individual shareholders are by nature mostly long-term driven** since 65% of their financial assets (and much more when property is included) are deployed in long-term investments[2] and their main saving goals are long-term: retirement, housing, children's studies, transmission of wealth, etc.. Even more, their long-term interests and environmental and social preferences are aligned with the society at large. Not considering these aspects would also miss the link with the Capital Market Union (CMU) initiative and with its objectives to foster retail investments into capital markets. Therefore, we do not consider that there is a need to prescribe the director's duty of care in EU law as in our view national laws and court rulings have over a long period of time developed a sufficiently effective framework that does not restrict too narrowly managers/directors leeway in decision-making and gives them safe harbours for management actions (business judgment rule).
Due diligence duty	Any initiative should build on existing initiatives such as the OECD guidelines for Multinational enterprises.[3] In addition, we encourage the EC Commission to extend the revision of the concept of double materiality of the Non-Financial Reporting to the due diligence duty of company's supply chain. The disclosure process across the supply chain could be based on a double materiality criterion defined as: 1) The potential/actual impact of sustainability risks on the financial performance, reputation and activities of the companies over the short and long-term 2) AND the potential/actual impact of sustainability risks generated by the company on the environment, society and local communities, over the short and long-term. In the context of due diligence, it is necessary to ensure a proportionate approach regarding rules implemented for small and medium-sized enterprises (SMEs) in order to avoid administrative burden Finally, SMEs are essential to Europe's competitiveness and prosperity, but despite the benefits of public listings, EU markets struggle to attract new issuers, it is therefore necessary - in order to encourage capital flows to ESG projects and listing of SMEs: • To increase the attractiveness of EU stock exchanges for EU SMEs. • To strengthen the IPO market in Continental Europe.

[2] Property and equity (directly and indirectly through investment funds, life insurance and pension products); Eurozone only; Sources : ECB statistics and BETTER FINANCE estimates

[3] https://www.oecd.org/corporate/mne/

Other elements of sustainable corporate governance	In BETTER FINANCE's view there is no need for introducing a legal requirement and forcing directors to engage with all stakeholders. We encourage the European Commission to have a closer look at solution adopted in different Member States and draw the conclusions from the outcomes. For instance, in the Netherlands it is foreseen (only in their corporate governance code) that companies should engage with their stakeholders on their executive compensation policy. As a result companies have to discuss their compensation policy with all stakeholders, including churches, employees, civil society representatives and the various shareholders. Naturally, since views of these stakeholders are totally diverging it is extremely difficult to find a way to derive from this an adequate policy. In BETTER FINANCE's opinion, compensation policy is one of the main tasks of the board of directors and should remain with it. We do encourage **EU to give priority to strengthen shareholders engagement and to facilitate the use of their rights at general meetings.** Regarding employee engagement, we think they should have a role in the enforcement of directors' duty of care whenever they act as shareholders that take the risks by investing in a company. In such cases we see for example a dire need to promote and incentivize **Employee Share Ownership (ESO)** throughout the EU to increase the resilience of businesses and reduce employment-fluctuation in times of economic crisis. ESO leads to an increased long-term engagement of employee shareholders with a stronger focus of companies on sustainability and improving the corporate governance of the companies they are invested in.

About BETTER FINANCE

BETTER FINANCE, the European Federation of Investors and Financial Services Users, is the public interest non-governmental organisation advocating and defending the interests of European citizens as 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. It is the one and only European-level organisation solely dedicated to the representation of individual investors, savers and other financial services users.

BETTER FINANCE acts as an independent financial expertise and advocacy centre 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.

Instructions on how to read this paper: this document contains the response of BETTER FINANCE to the European Commission's online survey (public consultation) concerning the **Sustainable Corporate Governance Framework,** but this is not the actual response form submitted and the document contains only the questions answered by BETTER FINANCE. The non-answered questions are deleted from the document. For each section summaries and explanations (*in italic*) are reported exactly as in the EC consultation document.[4]

[4] https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12548-Sustainable-corporate-governance/public-consultation

Introduction

This initiative is complementary to the review of the Non-Financial Reporting Directive (NFRD, Directive 2014/95/EU[5] which currently requires large public-interest companies to disclose to the public certain information on how they are affected by non-financial issues, as well as on the company's own impacts on society and the environment. The NFRD also requires companies to report on their social and environmental policies and due diligence processes if they have them, or otherwise explain why they do not have any (comply or explain approach). Whilst the NFRD is based on incentives "to report", the sustainable corporate governance initiative aims to introduce duties "to do". Such concrete actions would therefore contribute to avoiding "greenwashing" and reaching the objectives of the on-going review of the NFRD too, in particular the aim of enhancing the reliability of information disclosed under the NFRD by ensuring that the reporting obligation is underpinned by adequate corporate and director duties, and the aim of mitigating systemic risks in the financial sector. Reporting to the public on the application of sustainability in corporate governance and on the fulfilment of directors' and corporate duties would enable stakeholders to monitor compliance with these duties, thereby helping ensure that companies are accountable for how they mitigate their adverse environmental and social impacts.

The initiative would build upon relevant international standards on business and human rights and responsible business conduct, such as the United Nations' Guiding Principles on Businesses and Human Rights and the OECD Guidelines for Multinational Enterprises and its Due Diligence Guidance for Responsible Business Conduct.

As regards environmental harm linked to deforestation, the Commission is also conducting a fitness check of the EU Timber Regulation and an impact assessment.

Finally, Covid-19 has put small and medium sized companies under financial pressure, partly due to increased delay in the payments from their larger clients. This raises the importance of the role of board members of companies to duly take into account the interests of employees, including those in the supply chains as well as the interests of persons and suppliers affected by their operations. Further support measures for SMEs also require careful consideration.[6]

Consultation questions

I: Need and objectives for EU intervention on sustainable corporate governance

Question 1. Due regard for stakeholder interests', such as the interests of employees, customers, etc., is expected of companies. In recent years, 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

[5] https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32014L0095

[6] https://ec.europa.eu/eusurvey/runner/Autumn2020publicconsultationsustainablecorporategovernance?surveylanguage=en

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.**
- Do not know.

Please provide reasons for your answer:

BETTER FINANCE considers noteworthy the aim of the EC Commission to establish a European framework on Sustainable Corporate governance in order t to better hold directors accountable to long term oriented stakeholders. However, the entire initiative is based on a study[7] that has some methodological flaws and provides misleading interpretation of the shareholder's roles. Furthermore, we would like to remind the Commission that the Taxonomy Regulation has just been enacted and other initiatives like the Green Deal are also on the table. **The outcome of this important EU legislation should be awaited in order to avoid overregulation and before intervening deeply into national company laws.**

BETTER FINANCE would like to stress once again that EU citizens as individual shareholders are not short-term driven, they are by nature mostly long-term driven since 65% of their total assets are deployed in long-term investments[8] and their main saving goals are long-term: retirement, housing, children's studies, transmission of wealth, etc.

EC Study on directors' duties and sustainable corporate governance

The EY study should not been taken into consideration as a base for any EU policy and legislative intervention for various reasons.

- First, it shows a **lack of representativeness**. Key players in the European capital markets representing EU citizens such as BETTER FINANCE, the only EU-level organization representing altogether more than 4.5 million investors and DSW, the no.1 association for private investors in Germany with more than 30.000 members, were not even invited to take part in this study**. The study is further non-transparent** on which companies were taken into consideration which would have been an important factor to bear in mind for the public.
- Furthermore, this study is based on a **wrong view of shareholders** and therefore offers the wrong conclusions. It first and foremost completely ignores the fact that it is the shareholders carrying the risk of a total loss. Wirecard is only one but a very prominent example here. As a risk premium shareholder can receive dividends, the importance of which increased in times of negative interest rates especially for those non-professional investors that invest in order to get repayments to finance their pensions. In most cases private investors reinvest their dividends again in listed companies, so this money is not lost from the point of view of the society.
- Also, it is **important to differentiate between different kinds of companies**: those from traditional industries with rather low growth rates. Those companies usually pay a good dividend in order to maintain their shareholders in the company. Growth companies have a different approach. They want to invest as much as possible in their future growth and their shareholders can possibly profit from a good share price development. These growth companies usually do not pay a high dividend since they show a much higher need for future investments. Since shareholders take risks by investing their money, they receive as a compensation the right to have a say as one of the owners of the company. This is an important part of their property rights. All company laws in Europe acknowledge this fact just as in the case of owners of apartments. Of course, we strongly encourage all other stakeholders, especially employees, to become

[7] Study on directors' duties and sustainable corporate governance https://op.europa.eu/en/publication-detail/-/publication/e47928a2-d20b-11ea-adf7-01aa75ed71a1/language-en

[8] Property and equity (directly and indirectly through investment funds, life insurance and pension products); Eurozone only; Sources: ECB statistics and BETTER FINANCE estimates.

shareholders and also profit from their investment in shares in order to also have the opportunity and use their rights as shareholders. This could also be used to strengthen sustainability aspects in the general assembly.

- In addition, the study does not properly take into account that **there are different kinds of shareholders, among them "institutional" professional "investors" (better characterized as "agency owners") and private shareholders with different horizons and risks/rewards of their investments**. A recent study from Professor Matti Keloharju, Aalto University (2020) that was based on data from Euroclear Finland between 1995 and 2017 for example shows that <u>the average holding period of Finnish individuals was 135 trading days while that of Finnish financial and insurance corporations was only six trading days</u>. The study further demonstrates that short-termism has not increased over time. Also, this study is a clear renunciation of the EU Commission's hitherto existing assessment that the main source of funding and long-term value creation stems from the EU households' ability to finance the EU economy via more involvement in capital markets.

We believe the EC is very right to address the issue of sustainable corporate governance. It should focus on lowering the barriers to the long-term engagement from the end-investors, i.e. the EU citizens as individual investors and long term and pension savers. They are indeed the ones bearing most of the risks (and parts of the rewards) of share ownership, either as direct or as indirect investors. Otherwise, sustainable value for money and pension adequacy will be harder to reach.

Question 2. Human rights, social and environmental due diligence requires companies to put in place continuous processes to identify risks and adverse impacts on human rights, health and safety and environment and prevent, mitigate and account for such risks and impacts in their operations and through their value chain.

In the survey conducted in the context of the study on due diligence requirements through the supply chain, a broad range of respondents expressed their preference for a policy change, with an overall preference for establishing a mandatory duty at EU level.

Do you think that an EU legal framework for supply chain due diligence to address adverse impacts on human rights and environmental issues should be developed?

- ✓ **<u>Yes, an EU legal framework is needed.</u>**
- No, it should be enough to focus on asking companies to follow existing guidelines and standards.
- No action is necessary.
- Do not know.

Please explain:

BETTER FINANCE agrees with the necessity to create an EU legal framework on obligation for companies in order to address adverse sustainability impacts **respecting however the proportionality**. The

framework could build on the ongoing initiative of the UN on legally binding measures on transnational corporations and other business enterprises with respect to human rights.[9]

Question 3. If you think that an EU legal framework should be developed, please indicate which among the following possible benefits of an EU due diligence duty is important for you (tick the box/multiple choice)?

- ✓ **Ensuring that the company is aware of its adverse human rights, social and environmental impacts and risks related to human rights violations other social issues and the environment and that it is in a better position to mitigate these risks and impacts.**
- ✓ **Contribute effectively to a more sustainable development, including in non- EU countries.**
- ✓ **Levelling the playing field, avoiding that some companies freeride on the efforts of others.**
- ✓ **Increasing legal certainty about how companies should tackle their impacts, including in their value chain.**
- A non-negotiable standard would help companies increase their leverage in the value chain.
- Harmonisation to avoid fragmentation in the EU, as emerging national laws are different.
- SMEs would have better chances to be part of EU supply chains.
- Other

Other, please specify:

Question 3a. Drawbacks. Please indicate which among the following possible risks/drawbacks linked to the introduction of an EU due diligence duty are more important for you (tick the box /multiple choice)?

- ✓ **Increased administrative costs and procedural burden**
- ✓ **Penalisation of smaller companies with fewer resources**
- ✓ **Competitive disadvantage vis-à-vis third country companies not subject to a similar duty**
- ✓ **Responsibility for damages that the EU company cannot control**
- ✓ **Decreased attention to core corporate activities which might lead to increased turnover of employees and negative stock performance**
- ✓ **Difficulty for buyers to find suitable suppliers which may cause lock-in effects (e.g. exclusivity period/no shop clause) and have also negative impact on business performance of suppliers**
- ✓ **Disengagement from risky markets, which might be detrimental for local economies**
- ✓ Other

Other, please specify:

[9] https://www.ohchr.org/Documents/HRBodies/HRCouncil/WGTransCorp/Session6/OEIGWG_Chair-Rapporteur_second_revised_draft_LBI_on_TNCs_and_OBEs_with_respect_to_Human_Rights.pdf

II: Directors' duty of care – stakeholders' interests

In all Member States the current legal framework provides that a company director is required to act in the interest of the company (duty of care). However, in most Member States the law does not clearly define what this means. Lack of clarity arguably contributes to short-termism and to a narrow interpretation of the duty of care as requiring a focus predominantly on shareholders' financial interests. It may also lead to a disregard of stakeholders' interests, despite the fact that those stakeholders may also contribute to the long- term success, resilience and viability of the company.

Question 5 Which of the following interests do you see as relevant for the long- term success and resilience of the company?

	Relevant	Not Relevant	IDK/No Position
the interests of shareholders	X		
the interests of employees	X		
the interests of employees in the company's supply chain			X
the interests of customers	X		
the interests of persons and communities affected by the operations of the company	X		
the interests of persons and communities affected by the company's supply chain			X
the interests of local and global natural environment, including climate	X		
the likely consequences of any decision in the long term (beyond 3-5 years)	X		
the interests of society, please specify	X		
other interests, please specify			

The interests of society, please specify:

Yes, if understood as corporate citizen.

Other interests, please specify

Question 6. Do you consider that corporate directors should be required by law to (1) identify the company´s stakeholders and their interests, (2) to manage the risks for the company in relation to stakeholders and their interests, including on the long run (3) and to identify the opportunities arising from promoting stakeholders' interests?

	I Strongly agree	I Agree to some extent	I disagree to some extent	I strongly disagree	I do not know	I do not take position

Identification of the company´s stakeholders and their interests			X			
Management of the risks for the company in relation to stakeholders and their interests, including on the long run			X			
Identification of the opportunities arising from promoting stakeholders' interests			X			

Please explain:

Board of directors should find the right balance between the interests of their employees and the high priority interest of their customers and ensure that the shareholders are adequately represented.

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. Better and sustainable governance is more to be improved by ensuring "agency owners" like pension and investment funds and unit-linked insurers (who all legally "own" the shares of EU companies, but actually transfer all of the investment risks and part of the rewards to their individual clients) have the adequate governance to enable those clients to engage as indirect owners.

Question 7. Do you believe that corporate directors should be required by law to set up adequate procedures and where relevant, measurable (science –based) targets to ensure that possible risks and adverse impacts on stakeholders, ie. human rights, social, health and environmental impacts are identified, prevented and addressed?

- I strongly agree
- I agree to some extent
- ✓ **I disagree to some extent**
- I strongly disagree
- I do not know
- I do not take position

Please explain:

We believe that the setup of adequate procedures and measurable (science-based) targets to ensure possible risks and adverse impacts on stakeholders is also encouraged by the ongoing legislation on non-financial reporting (Directive 2014/95/EU). Therefore, the Commission should ensure coherence and avoid over-regulation on these aspects.

Question 8. Do you believe that corporate directors should balance the interests of all stakeholders, instead of focusing on the short-term financial interests of shareholders, and that this should be clarified in legislation as part of directors' duty of care?

- I strongly agree
- I agree to some extent
- I disagree to some extent
- ✓ **I strongly disagree**
- I do not know
- I do not take position

Please provide explanation or comment:

Referring to "*short-term financial interests of shareholders*" is highly questionable and fails to consider differences among shareholders.

BETTER FINANCE's member organisation *Deutsche Schutzvereinigung für Wertpapierbesitz e.V* (DSW) is also very surprised to read in the EC study that there exists a "*primacy of shareholders' interests*" at companies or that shareholders' interests prevail at companies which is certainly not the case of individual shareholders. This does not reflect DSW daily work and experience at 600 German AGM's per year. DSW as an organization now has existed for more than 70 years in Germany but they always had and still have to fight for the rights of shareholders as the last Annual General Meetings' season with the virtual shareholders meetings under strong restrictions showed. The German view on listed companies is very much influenced by aspects of co-determination also at the board level in German supervisory boards. Already today there is a strong influence of employees as another stakeholder group on the decisions of the management boards and this system so far proved to be successful and resistant. Taking other stakeholder interests into considerations is a long-lasting tradition in Germany - not a new model. In our view it is the task of the management to find the right balance between the interests of their employees and the high priority interest of their customers. We all know that no company can be successful without satisfied customers and well-motivated employees. Moreover, already today other stakeholders' interests are taken into consideration as the environment and the task of the company as a corporate citizen. These aspects will further increase in importance once applying the New Green Deal and the taxonomy from 2022 on.

We underline that referring to "*short-term financial interests of shareholders*" is highly questionable, ignores individual shareholders, and fails to consider differences among shareholders. **EU citizens as individual shareholders are by nature mostly long-term driven** since 65% of their financial assets (and much more when property is included) are deployed in long-term investments[10] and their main saving goals are long-term: retirement, housing, children's studies, transmission of wealth, etc.. Even more, their long-term interests and environmental and social preferences are aligned with the society at large. Not considering these aspects would also miss the link with the Capital Market Union (CMU) initiative and with its objectives to foster retail investments into capital markets.[11]

The objective of the Capital Markets Union (CMU) is to get money – investments and savings – flowing across the EU so that it can benefit consumers, investors and companies, regardless of where they are located. Even though the importance of such a CMU has been recognized for some time it is today more urgent than ever: The impact of the COVID-19 pandemic will last for years and the recovery will be very challenging as all economies are facing much higher levels of public and private debt and numerous businesses are affected by a prolonged lockdown. As a consequence, they will require substantial new

[10] Property and equity (directly and indirectly through investment funds, life insurance and pension products); Eurozone only; Sources : ECB statistics and BETTER FINANCE estimates
[11] https://www.ecmi.eu/sites/default/files/are_european_listed_corporations_short_termist.pdf

forms of equity funding. Next to that, Brexit poses additional challenges to the EU financial structures with the risk of more fragmentation, loss of liquidity and increased costs for investors. A CMU that helps to tackle these challenges is therefore essential to attain sustainable growth in the EU as a fully functioning and integrated market for capital will allow the EU's economy to grow in a sustainable way and be more competitive. While we are very supportive of finalizing the CMU, we are concerned about the path the EU Commission now seems willing to enter regarding sustainable corporate governance by considering a series of measures based on the conclusions drawn from the study on directors' duties and sustainable governance prepared by EY (EY study[12]).

Question 9. Which risks do you see, if any, should the directors' duty of care be spelled out in law as described in question 8?

We do not consider that there is a need to spell out the director's duty of care in EU law as in our view national laws and court rulings have over a long period of time developed a sufficiently effective framework that does not restrict too narrowly managers/directors leeway in decision-making and gives them safe harbours for management actions (business judgment rule). This would be at risk should the directors' duties be prescribed as per question 8. A recent research paper[13] reveals that the major problem with the EY study is that it does not consider the central principle of corporate law policy regarding the judicial enforcement of business aspects of fiduciary duties.

How could these possible risks be mitigated? Please explain.

Where directors widely integrate stakeholder interest into their decisions already today, did this gather support from shareholders as well? Please explain

Yes, this is already part of the corporate culture in many Member States. Over recent years there has been an increased support for shareholder proposals related to climate or environment topics. We point to the example of Bayer AG, a German DAX 30 company, where the shareholders, for the first time in German corporate history, refused to approve the management board at the general meeting 2019. The reason behind this was the acquisition of Monsanto, which resulted in mounting legal problems that in the end led to a disastrous share price performance. It has to be noted, however, that stakeholders and shareholders often use other avenues (direct engagement). Voicing their concerns at general meetings with own proposals often marks the end of an escalated engagement process and not its beginning. In any case we consider that further research in this area is warranted.

Question 10. As companies often do not have a strategic orientation on sustainability risks, impacts and opportunities, as referred to in question 6 and 7, do you believe that such considerations should be integrated into the company's strategy, decisions and oversight within the company?

- I strongly agree
- I agree to some extent.

[12] https://op.europa.eu/en/publication-detail/-/publication/e47928a2-d20b-11ea-adf7-01aa75ed71a1/language-en

[13] The European Commission's Sustainable Corporate Governance Report: A Critique Mark Roe Holger Spamann Jesse Fried Charles Wang, Harvard business school (Pag16) https://www.hbs.edu/faculty/Publication%20Files/21-056_51410b50-5488-477a-9aa3-df8f81138e53.pdf

- ✓ **I disagree to some extent.**
- I strongly disagree.
- I do not know.
- I do not take position.

Please explain:

Already the question itself builds on a misperception of the real situation at companies by stating that companies often do not have a strategic orientation on sustainability risks etc. In our experience, companies very often have a strategic orientation on sustainability risks, impacts and opportunities which will be supported further by the Taxonomy Regulation and the upcoming NFRD.

We note, however, that the current **composition of the boards** does not reflect the aspect of sustainability in a sufficient manner. If we take a look at the German two-tier board system with co-determination and employees being members of the supervisory board this is not reflected with regard to the social aspects. Nevertheless, we acknowledge that specific expertise in the field of sustainability could be useful. This expertise and knowledge should be part of the future profile of competencies for the board which is usually being developed by the nomination committee. The best would be to have a representative on the board who represents all three aspects of ESG in person to ensure that all aspects are being considered.

Non-financial reporting and accounting: As taxonomy is reaching the listed companies, the quality of information with respect to ESG is increasing. Since we currently see a lack of harmonized Key Performance Indicators and a lack of common International Accounting Standards on ESG, there is a strong need to develop those as soon as possible. There are already several initiatives also from EFRAG working on this issue. Also, the review of the CSR reporting (NFRD) will focus on this aspect.

Enforcement of directors' duty of care

Today, enforcement of directors' duty of care is largely limited to possible intervention by the board of directors, the supervisory board (where such a separate board exists) and the general meeting of shareholders. This has arguably contributed to a narrow understanding of the duty of care according to which directors are required to act predominantly in the short-term financial interests of shareholders. In addition, currently, action to enforce directors' duties is rare in all Member States.

Question 11. Are you aware of cases where certain stakeholders or groups (such as shareholders representing a certain percentage of voting rights, employees, civil society organisations or others) acted to enforce the directors' duty of care on behalf of the company? How many cases? In which Member States? Which stakeholders? What was the outcome?

Please describe examples:

A very recent example is the proposal of the employee shareholders at Siemens AG at the general meeting 2021.[14] They proposed to enhance the governance of the company and strengthen shareholders' rights (which are currently severely restricted, see BF report on the future of AGMs) at virtual general meetings by proposing an amendment to the Articles of Association requesting that "it shall be ensured at a virtual

[14] https://assets.new.siemens.com/siemens/assets/api/uuid:d7b11b42-0d45-4b94-8202-2ccff91097c2/Amendment-Agenda-ASM2021.pdf

Shareholders' Meeting that shareholders can submit questions while the Shareholders' Meeting is ongoing". Another example is the general meeting of Volkswagen 2016, where DSW, the German shareholder association, launched a special investigation by an independent auditor to reveal deficiencies in corporate culture/compliance/risk management at the company. Also, especially in the Netherlands and the UK, environmental shareholder proposals aiming for example at reducing the carbon footprint or requiring companies to adhere to the Paris agreement2015 are increasingly gaining support at general meetings.

Question 12. What was the effect of such enforcement rights/actions? Did it give rise to case law/ was it followed by other cases? If not, why?

Please describe:

The main problem is that shareholders have no collective redress means to meaningfully enforce their rights towards companies collectively. In addition, in some Member States there is no direct liability of directors towards their shareholders. Here, the Commission would have ample means to improve the situation but up to now was reluctant to implement especially such a right to collective redress for shareholders even despite the disastrous Wirecard scandal.

Question 13 : Do you consider that stakeholders, such as for example employees, the environment or people affected by the operations of the company as represented by civil society organisations should be given a role in the enforcement of directors' duty of care?

Please explain your answer:

Yes, whenever they act as shareholders that take the risks by investing in a company. In such cases we see for example a dire need to promote and incentivize Employee Share Ownership (ESO) throughout the EU to increase the resilience of businesses and reduce employment-fluctuation in times of economic crisis. This is also a key recommendation from the ECON Committee of the EP and of the HLF CMU[15]. ESO leads to an increased long-term engagement of employee shareholders with a stronger focus of companies 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. 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.[16]
In addition, a central role should be given in particular **to individual shareholders as major company's stakeholders** as they have a long-term interest. The right to vote at a general meeting is a fundamental shareholder right. Individual shareholders should have the opportunity to exercise their voting rights and take responsibilities as owners of listed companies also across borders. Despite the adoption of the Shareholder Rights Directive II, its Implementing Regulation and the best practice standards developed and endorsed by the industry, there are still many obstacles and barriers investors have to face which continue to make cross-border voting a challenge. A significant increase in cross-border voting by individual shareholders cannot be expected unless their factual discrimination resulting from the obstacles is abolished. Therefore, to individual shareholders **should be given a better role in the enforcement of directors' duty of care.**

[15] But surprisingly and sadly not taken on board by the EC in its latest CMU Action Plan.
[16] David P. Ellerman & Tej Gonza, "COVID-19: Government Aid that also promotes Employee Ownership",

Question 13a : In case you consider that stakeholders should be involved in the enforcement of the duty of care, please explain which stakeholders should play a role in your view and how.

Yes, in case they become shareholders of the company and bear the same risks as owners.

III: Due diligence duty

For the purposes of this consultation, "due diligence duty" refers to a legal requirement for companies to establish and implement adequate processes with a view to prevent, mitigate and account for human rights (including labour rights and working conditions), health and environmental impacts, including relating to climate change, both in the company's own operations and in the company's the supply chain. "Supply chain" is understood within the broad definition of a company's "business relationships" and includes subsidiaries as well as suppliers and subcontractors. The company is expected to make reasonable efforts for example with respect to identifying suppliers and subcontractors. Furthermore, due diligence is inherently risk-based, proportionate and context specific. This implies that the extent of implementing actions should depend on the risks of adverse impacts the company is possibly causing, contributing to or should foresee.

Question 14. Please explain whether you agree with this definition and provide reasons for your answer.

Any initiative could build on the OECD guidelines for Multinational enterprises. [17] In addition, we encourage the EC Commission to extend the revision of the concept of double materiality of the Non-Financial reporting to the due diligence duty of company's supply chain. The disclosure process across the supply chain should be based on a double materiality criterion defined as: 1) The potential/actual impact of sustainability risks on the financial performance, reputation and activities of the companies over the short and long-term 2) AND the potential/actual impact of sustainability risks generated by the company on the environment, society and local communities, over the short and long-term.

5000 character(s) maximum

including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

Question 15. Please indicate your preference as regards the content of such possible corporate due diligence duty (tick the box, only one answer possible). Please note that all approaches are meant to rely on existing due diligence standards, such as the OECD guidance on due diligence or the UNGPs. Please note that Option 1, 2 and 3 are horizontal i. e. cross-sectorial and cross thematic, covering human rights, social and environmental matters. They are mutually exclusive. Option 4 and 5 are not horizontal, but theme or sector-specific approaches. Such theme specific or sectorial approaches can be combined with a horizontal approach (see question 15a). If you are in favour of a combination of a horizontal approach with a theme or sector specific approach, you are requested to choose one horizontal approach (Option 1, 2 or 3) in this question.

- ✓ **Option 1. "Principles-based approach": A general due diligence duty based on key process requirements (such as for example identification and assessment of risks, evaluation of the operations and of the supply chain, risk and impact mitigation actions, alert mechanism, evaluation of the effectiveness of measures, grievance mechanism, etc.) should be defined at EU level regarding identification, prevention and mitigation of relevant human rights, social and environmental risks and negative impact. These should be applicable across all sectors. This could be complemented by EU- level general or sector specific guidance or rules, where necessary**
- Option 2. "Minimum process and definitions approach": The EU should define a minimum set of requirements with regard to the necessary processes (see in option 1) which should be applicable across all sectors. Furthermore, this approach would provide harmonised definitions

[17] https://www.oecd.org/corporate/mne/

for example as regards the coverage of adverse impacts that should be the subject of the due diligence obligation and could rely on EU and international human rights conventions, including ILO labour conventions, or other conventions, where relevant. Minimum requirements could be complemented by sector specific guidance or further rules, where necessary.

- Option 3. "Minimum process and definitions approach as presented in Option 2 complemented with further requirements in particular for environmental issues". This approach would largely encompass what is included in option 2 but would complement it as regards, in particular, environmental issues. It could require alignment with the goals of international treaties and conventions based on the agreement of scientific communities, where relevant and where they exist, on certain key environmental sustainability matters, such as for example the 2050 climate neutrality objective, or the net zero biodiversity loss objective and could reflect also EU goals. Further guidance and sector specific rules could complement the due diligence duty, where necessary.
- Option 4 "Sector-specific approach": The EU should continue focusing on adopting due diligence requirements for key sectors only.
- Option 5 "Thematic approach": The EU should focus on certain key themes only, such as for example slavery or child labour.
- None of the above, please specify

Please specify:

Question 15a. If you have chosen option 1, 2 or 3 in Question 15 and you are in favour of combining a horizontal approach with a theme or sector specific approach, please explain which horizontal approach should be combined with regulation of which theme or sector?

Question 15b. Please provide explanations as regards your preferred option, including whether it would bring the necessary legal certainty and whether complementary guidance would also be necessary.

It is extremely important to provide consistent definitions among regulations. In this case the definition of adverse impacts should be aligned with the definition provided by the disclosure regulation: *"(20) Financial market participants which consider the principal adverse impacts of investment decisions on sustainability factors should disclose in the pre-contractual information for each financial product, concisely in qualitative or quantitative terms, how such impacts are considered as well as a statement that information on the principal adverse impacts on sustainability factors is available in the ongoing reporting.* ***Principal adverse impacts should be understood as those impacts of investment decisions and advice that result in negative effects on sustainability factors****."*[18]

In addition, a clear list of adverse impact aspects should be provided in the context of due diligence rules. The environmental issues should be aligned with the 6 environmental objectives of the taxonomy regulation: *(1) climate change mitigation; (2) climate change adaptation; (3) sustainable use and protection of water and marine resources; (4) transition to a circular economy, waste prevention and recycling; (5) pollution prevention and control; (6) protection of healthy ecosystems.*[19]

[18] https://eur-lex.europa.eu/eli/reg/2019/2088/oj
[19] https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/documents/sustainable-finance-taxonomy-spotlight_en.pdf

Rules in terms of social matters should cover the ILO conventions and employees' issues such as safety, human capital management, trade union relationship, health etc.

Any criteria need to be consistent with the Non-financial reporting directive (NFRD) and other relevant accounting standards.

5000 character(s) maximum

including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

Question 15c. If you ticked options 2) or 3) in Question 15 please indicate which areas should be covered in a possible due diligence requirement (tick the box, multiple choice)

- Human rights, including fundamental labour rights and working conditions (such as occupational health and safety, decent wages and working hours) Interests of local communities, indigenous peoples' rights, and rights of vulnerable groups
- Climate change mitigation
- Natural capital, including biodiversity loss; land degradation; ecosystems degradation, air, soil and water pollution (including through disposal of chemicals); efficient use of resources and raw materials; hazardous substances and waste
- Other, please specify

Other, please specify:

Question 15d. If you ticked option 2) in Question 15 and with a view to creating legal certainty, clarity and ensuring a level playing field, what definitions regarding adverse impacts should be set at EU level?

Question 15e. If you ticked option 3) in Question 15, and with a view to creating legal certainty, clarity and ensuring a level playing field, what substantial requirements regarding human rights, social and environmental performance (e.g. prohibited conducts, requirement of achieving a certain performance/target by a certain date for specific environmental issues, where relevant, etc.) should be set at EU level with respect to the issues mentioned in 15c?

Question 15f. If you ticked option 4) in question 15, which sectors do you think the EU should focus on?

Question 15g. If you ticked option 5) in question 15, which themes do you think the EU should focus on?

Question 16. How could companies'- in particular smaller ones'- burden be reduced with respect to due diligence? Please indicate the most effective options (tick the box, multiple choice possible)

This question is being asked in addition to question 48 of the Consultation on the Renewed Sustainable Finance Strategy, the answers to which the Commission is currently analysing.

- ✓ **All SMEs[20] should be excluded**
- SMEs should be excluded with some exceptions (e.g. most risky sectors or other)
- Micro and small sized enterprises (less than 50 people employed) should be excluded
- Micro-enterprises (less than 10 people employed) should be excluded SMEs should be subject to lighter requirements ("principles-based" or "minimum process and definitions" approaches as indicated in Question 15)
- SMEs should have lighter reporting requirements
- Capacity building support, including funding
- Detailed non-binding guidelines catering for the needs of SMEs in particular
- ✓ **Toolbox/dedicated national helpdesk for companies to translate due diligence criteria into business practices**
- ✓ Other option, please specify
- ✓ None of these options should be pursued

Please explain your choice, if necessary:

Facing difficulties to obtain finance and high compliance costs, coupled with a drop in risk equity research, caused the number of publicly listed SMEs companies to fluctuate and, overall, decrease from 2014 (1180) to 2018 (1137), with the market capitalization of their shares dropping dramatically from €122.1 billion to €53.45 billion in 2018 (-56%).

Small and medium-sized enterprises are essential to Europe's competitiveness and prosperity. Despite the benefits of public listings, EU markets struggle to attract new issuers. Therefore, in order to encourage capital flows to ESG projects and listing of SMEs, it is necessary as first:

- **To increase the attractiveness of EU stock exchanges for EU SMEs** in general, e.g. through tax incentives. EU stock markets are still struggling to attract IPOs while London is the most important market for IPOs. The Commission should build on the experience and expertise built up in well-established capital markets to find out how to make EU stock exchanges more attractive.

- **To strengthen the IPO market in Continental Europe**. The Commission should review the regulatory barriers to small firms for their admission to trading on public markets to ensure that the regulatory environment for the SME Growth Markets is fit for purpose.

Therefore, in the context of due diligence it is necessary to ensure a proportionate approach regarding rules implemented for SMEs in order to avoid administrative burden. It is also extremely important to align the requirements with the thresholds established in the NFRD to avoid any regulatory mismatch.

Therefore, the EC commission should take into consideration SMEs that might be contracting companies with large ones and to avoid risks of penalisation of small companies with limited resources.

Question 17. In your view, should the due diligence rules apply also to certain third- country companies which are not established in the EU but carry out (certain) activities in the EU?

- ✓ **Yes**

[20] https://ec.europa.eu/growth/smes/sme-definition_en

- No
- I do not know

Question 17a. What link should be required to make these companies subject to those obligations and how (e.g. what activities should be in the EU, could it be linked to certain turnover generated in the EU, other)? Please specify.

We agree to extend this framework to companies not established in the EU but operating in the EU. This approach would contribute to reach the targets set in the EU green deal and will provide a level playing field for all companies in the EU market.

The scope of the application of due diligence rules for third country companies should be aligned with taxonomy criteria (turnover/ balance sheet threshold). The threshold will allow to identify companies that have a strong impact on the environment and society.

Question 17b. Please also explain what kind of obligations could be imposed on these companies and how they would be enforced.

The same requirements established for EU companies also with regard to enforcement to establish a level playing field.

Question 18. Should the EU due diligence duty be accompanied by other measures to foster more level playing field between EU and third country companies?

- Yes
- ✓ **No**
- I do not know

Please explain:

No need for additional measures.

Question 19. Enforcement of the due diligence duty

Question 19a. If a mandatory due diligence duty is to be introduced, it should be accompanied by an enforcement mechanism to make it effective. In your view, which of the following mechanisms would be the most appropriate one(s) to enforce the possible obligation (tick the box, multiple choice)?

- ✓ **Judicial enforcement with liability and compensation in case of harm caused by not fulfilling the due diligence obligations.**
- Supervision by competent national authorities based on complaints (and/or reporting, where relevant) about non-compliance with setting up and implementing due diligence measures, etc. with effective sanctions (such as for example fines).
- ✓ **Supervision by competent national authorities (option 2) with a mechanism of EU cooperation/coordination to ensure consistency throughout the EU**
- Other, please specify

Please provide explanation:

Question 19b. In case you have experience with cases or Court proceedings in which the liability of a European company was at stake with respect to human rights or environmental harm caused by its subsidiary or supply chain partner located in a third country, did you encounter or do you have information about difficulties to get access to remedy that have arisen ?

- Yes
- ✓ **<u>No</u>**

In case you answered yes, please indicate what type of difficulties you have encountered or have information about

If you encountered difficulties, how and in which context do you consider they could (should) be addressed?

IV: Other elements of sustainable corporate governance

Question 20. Stakeholder engagement

Better involvement of stakeholders (such as for example employees, civil society organisations representing the interests of the environment, affected people or communities) in defining how stakeholder interests and sustainability are included into the corporate strategy and in the implementation of the company's due diligence processes could contribute to boards and companies fulfilling these duties more effectively.

Question 20a. Do you believe that the EU should require directors to establish and apply mechanisms or, where they already exist for employees for example, use existing information and consultation channels for engaging with stakeholders in this area?

- I strongly agree
- I agree to some extent.
- I disagree to some extent
- ✓ **<u>I strongly disagree</u>**
- I do not know
- I do not take position

Please explain:

In BETTER FINANCE's view there is no need for introducing a legal requirement and forcing directors to engage with all stakeholders. We encourage the European Commission to have a closer look at solution adopted in different Member States and draw the conclusions from the outcomes. For instance, in the Netherlands it is foreseen (only in their corporate governance code) that companies should engage with their stakeholders on their executive compensation policy. As a result companies have to discuss their compensation policy with all stakeholder, including churches, employees, civil society representatives and the various shareholders. Naturally, since views of these stakeholders are totally diverging it is extremely difficult to find a way to derive from this an adequate policy. In BETTER FINANCE's opinion, compensation policy is one of the main tasks of the board of directors and should remain with it.

We believe the EU should give priority to strengthen shareholders engagement and to facilitate the use of their rights at general meetings.

Of course, we strongly encourage all other stakeholders, especially employees, to become shareholders and also profit from their investment in shares and use their rights as shareholders. This could also be used to strengthen sustainability aspects in the general meetings.

Question 20b. If you agree, which stakeholders should be represented? Please explain.

Question 20c. What are best practices for such mechanisms today? Which mechanisms should in your view be promoted at EU level? (tick the box, multiple choice)

	Is best practice	**Should be promoted at EU level**
Advisory body		
Stakeholder general meeting		
Complaint mechanism as part of due diligence		

Other, please specify:

None of the above.

Question 21. Remuneration of directors

Current executive remuneration schemes, in particular share-based remuneration and variable performance criteria, promote focus on short-term financial value maximisation[21] (Study on directors' duties and sustainable corporate governance).

Please rank the following options in terms of their effectiveness to contribute to countering remuneration incentivising short-term focus in your view.

This question is being asked in addition to questions 40 and 41 of the Consultation on the Renewed Sustainable Finance Strategy the answers to which the Commission is currently analysing. Ranking 1-7 (1: least efficient, 7: most efficient)

	*** 1 —> 7 ***
Restricting executive directors' ability to sell the shares they receive as pay for a certain period (e.g. requiring shares to be held for a certain period after they were granted, after a share buy-back by the company)	7
Regulating the maximum percentage of share-based remuneration in the total remuneration of directors	6
Regulating or limiting possible types of variable remuneration of directors (e. g.	3

[21] https://op.europa.eu/en/publication-detail/-/publication/e47928a2-d20b-11ea-adf7-01aa75ed71a1/language-en.

only shares but not share options)	
Making compulsory the inclusion of sustainability metrics linked, for example, to the company's sustainability targets or performance in the variable remuneration	
Mandatory proportion of variable remuneration linked to non-financial performance criteria	2
Requirement to include carbon emission reductions, where applicable, in the lists of sustainability factors affecting directors' variable remuneration	1
Taking into account workforce remuneration and related policies when setting director remuneration	
Other option, please specify	
None of these options should be pursued, please explain	

Please explain:

The workforce remuneration already needs to be taken into account, as per the Shareholder Rights Directives (SRD) II. The same goes for the requirement to include sustainability metrics in the variable remuneration. We would like to further point to the numerous rules already in place (binding through law or non-binding through codes or guidelines from supervisors or investors) that companies need to take into account when setting the remuneration of their executives. This proposal will further add to the complexity of remuneration policies and only serve the compensation advisory industry.

Directors' Pay: We would like to draw the EC's attention to the fact that past discussions on the "reward for failure" were drivers for the SRD II and led to a review of the directors' pay systems in Europe. For instance, in Germany we will find this AGM season most companies to put their directors' pay systems on the agenda asking shareholders to vote on the system and structure and on the report. These systems show a strong change in the variable part of the pay, now focusing more on long-term incentives and on non-financial key performance indicators to encourage the sustainability aspects at companies.

Again, individual investors/ shareholders are by nature mostly long-term driven and their main saving goals are long-term they should have an effective say on remuneration policy (in line with the Shareholders Rights Directive II "they should be granted the right to hold a binding or advisory vote on the remuneration policy, on the basis of a clear, understandable and comprehensive overview of the company's remuneration policy"). Ideally, as a consequence executive remuneration should fairly reward good corporate performance with a remuneration package that is linked to the achievement of stretching targets but that does not encourage imprudent risk-taking, excessive conservatism or continuation of strategies that are no longer appropriate or drive short-termism. The remuneration structure should be a balance between the director's interest and the company development (pay for performance).

Question 22. Enhancing sustainability expertise in the board.

Current level of expertise of boards of directors does not fully support a shift towards sustainability, so action to enhance directors' competence in this area could be envisaged[22] (Study on directors' duties and sustainable corporate governance).

[22] https://op.europa.eu/en/publication-detail/-/publication/e47928a2-d20b-11ea-adf7-01aa75ed71a1/language-en

Please indicate which of these options are in your view effective to achieve this objective (tick the box, multiple choice).

- Requirement for companies to consider environmental, social and/or human rights expertise in the directors' nomination and selection process.
- Requirement for companies to have a certain number/percentage of directors with relevant environmental, social and/or human rights expertise.
- Requirement for companies to have at least one director with relevant environmental, social and/or human rights expertise.
- ✓ **Requirement for the board to regularly assess its level of expertise on environmental, social and/or human rights matters and take appropriate follow-up, including regular trainings.**
- Other option, please specify.
- None of these are effective options.

Please explain:

The current **composition of the boards** does not reflect the aspect of sustainability in a sufficient manner. If we take a look at the German two-tier board system with co-determination and employees being members of the supervisory board this is not reflected with regard to the social aspects. Nevertheless, we acknowledge that specific expertise in the field of sustainability could be useful. This expertise and knowledge should be part of the future profile of competencies for the board which is usually being developed by the nomination committee. The best would be to have a representative on the board who represent all three aspects of ESG in person to ensure that all aspects are being considered.

Non-financial reporting and accounting: As taxonomy is reaching the listed companies, the quality of information with respect to ESG is increasing. Since we currently see a lack of harmonized Key Performance Indicators and a lack of common International Accounting Standards on ESG, there is a strong need to develop those as soon as possible. There are already several initiatives also from European Financial Reporting Advisory Group (EFRAG) working on this issue. Also, the review of the Corporate Social Responsibility (CSR) reporting will focus on this aspect.

Question 23. Share buybacks

Corporate pay-outs to shareholders (in the form of both dividends and share buybacks) compared to the company's net income have increased from 20 to 60 % in the last 30 years in listed companies as an indicator of corporate short-termism. This arguably reduces the company's resources to make longer-term investments including into new technologies, resilience, sustainable business models and supply chains[23]. (A share buyback means that the company buys back its own shares, either directly from the open market or by offering shareholders the option to sell their shares to the company at a fixed price, as a result of which the number of outstanding shares is reduced, making each share worth a greater percentage of the company, thereby increasing both the price of the shares and the earnings per share.) EU law regulates the use of share-buybacks [Regulation 596/2014 on market abuse and Directive 77/91, second company law Directive].

In your view, should the EU take further action in this area?

- I strongly agree

[23] https://op.europa.eu/en/publication-detail/-/publication/e47928a2-d20b-11ea-adf7-01aa75ed71a1/language-en

- I agree to some extent
- ✓ **I disagree to some extent**
- I strongly disagree
- I do not know
- I do not take position

Question 23a. If you agree, what measure could be taken?

The EC study does not consider other very relevant aspects that would strongly affect the recommendations of the report. The low level of interest rate of the recent years could have favoured companies to pay out shareholders instead of accumulating cash. In addition, the analysis does not provide enough information in terms of type of businesses, size, ownership and business model.[24]

The use of gross corporate pay out does not provide a clear picture of increasing or decreasing of short-term trends. It would be much more preferable to use net shareholder pay-outs which takes into consideration also direct and indirect issuance of equity by the company. Therefore, a different approach would have provided a more comprehensive picture instead of considering only the outflow of the company.[25]

Therefore, BETTER FINANCE would like to warn the EC against considering the conclusions of the report as a basis to establish EU actions on share buybacks.

Question 24: Do you consider that any other measure should be taken at EU level to foster more sustainable corporate governance?

If so, please specify:

Misalignment of interests: Several studies show that the decline of individual shareholdings has resulted in asset managers becoming the dominant players in the investment chain, and therefore holding the voting rights, i.e. the power to be active shareholders with remuneration mostly based on short-term performance despite UCITS V and AIFMD requirements to the detriment of long-term value creation. For example, UCITS V fails to link remuneration rules to the performance fee mechanisms of the funds themselves which remain ultra-short term when they exist. When they do not exist, the economic incentive is based on assets under management, not on performance, and not -a fortiori–on long term performance. This situation creates a misalignment of interests between economic shareowners (the beneficiaries) who are mostly long-term driven and the actions of fund managers. Moreover, the recent transition to intermediated holdings may lead to short-termism as there the end-investor is no longer the owner.

There are several studies arguing that institutional investors do not sufficiently engage with investee companies, preferring to respond to a poor performance by just selling their shares due to costly and time-consuming monitoring. The short-termism perspective sees institutional investors as transient intermediaries, who have high turnover portfolios, are focused on short-term performance, and fail to act as responsible stewards of the corporation. Indeed, an important pre-requisite is to define what is an "institutional investor". It is what Pr. John Kay (and long time before him one of the SEC founders Louis

[24] Karel Lannoo, Jesper Lau Hansen and Apostolos Thomadakis Are European listed corporations short-termist? (ECMI) January 2021 https://www.ecmi.eu/sites/default/files/are_european_listed_corporations_short_termist.pdf

[25] Ibid. (page 2-3)

Brandies) defines as "**other people's money**". Institutional investors are in the majority of cases better called investment managers, as they typically manage someone else's money, that of the end-investor, the beneficial owner. That is the case of investment funds, of pension funds and of a large part of the insurers' assets as well. In most cases if not all, the economic interests of investment managers have a much shorter time horizon than that of the investments they manage. On the other hand, all studies confirm that individual investors have on average a long-term horizon as their most important savings needs are long term: pension, housing, children education, wealth transmission.

Therefore, it is extremely important that the **Sustainable Corporate Governance framework acknowledges the difference between institutional shareholders and individual shareholders**, as the latter play a key role in terms of long-term value creation for the company as they interests are aligned with the society as whole in terms of environmental and social and governance issues.

Also, we would like to point to two deficiencies of SRD II: Firstly the directive only requires institutional investors to be transparent with regard to their engagement in companies. What is lacking, however, is a requirement to engage (build at least on a comply or explain basis). Secondly, we note that the Implementation of SRD II has further condensed the market of transmission of information between issuers and shareholders: Currently there is one technical platform provider dominating the market and we notice that in Germany especially small institutional investors, eg. wealth managers completely refrain from voting their shares at national level or abroad as the costs are too high and the intermediaries do not accept other solutions than the dominant player in the market. Further, we would deem it necessary that the Commission takes a closer look into the process how voting decisions at institutional investors come about: In our experience, institutional investors need to heavily rely on proxy advisors and do not have the resources to perform the full analysis in advance of a general meeting on their own. This leads to a significant impact of the two dominant proxy advisors in the market.

V: Impacts of possible measures

Question 25. Impact of the spelling out of the content of directors' duty of care and of the due diligence duty on the company Please estimate the impacts of a possible spelling out of the content of directors' duty of care as well as a due diligence duty compared to the current situation. In your understanding and own assessment, to what extent will the impacts/effects increase on a scale from 0-10? In addition, please quantify/estimate in quantitative terms (ideally as percentage of annual revenues) the increase of costs and benefits, if possible, in particular if your company already complies with such possible requirements.

	Non-binding guidance. **Rating 0-10**	Introduction of these duties in binding law, cost and benefits linked to setting up /improving external impacts' identification and mitigation processes **Rating 0 (lowest impact)-10 (highest impact) and quantitative data**	Introduction of these duties in binding law, annual cost linked to the fulfilment of possible requirements aligned with science-based targets (such as for example climate neutrality by 2050, net zero biodiversity loss, etc.) and possible reorganisation of supply chains **Rating 0 (lowest impact)-10**

			(highest impact) and quantitative data
Administrative costs including costs related to new staff required to deal with new obligations			
Litigation costs			
Other costs including potential indirect costs linked to higher prices in the supply chain, costs liked to drawbacks as explained in question 3, other than administrative and litigation costs, etc. Please specify.			
Better performance stemming from increased employee loyalty, better employee performance, resource efficiency			
Competitiveness advantages stemming from new customers, customer loyalty, sustainable technologies or other opportunities			
Better risk management and resilience			
Innovation and improved productivity			
Better environmental and social performance and more reliable reporting attracting investors			
Other impact, please specify			

Please explain:

Question 26. Estimation of impacts on stakeholders and the environment

A clarified duty of care and the due diligence duty would be expected to have positive impacts on stakeholders and the environment, including in the supply chain. According to your own understanding and assessment, if your company complies with such requirements or conducts due diligence already, please quantify / estimate in quantitative terms the positive or negative impact annually since the introduction of the policy, by using examples such as:

- Improvements on health and safety of workers in the supply chain, such as reduction of the number of accidents at work, other improvement on working conditions, better wages, eradicating child labour, etc.

- Benefits for the environment through more efficient use of resources, recycling of waste, reduction in greenhouse gas emissions, reduced pollution, reduction in the use of hazardous material, etc.

- Improvements in the respect of human rights, including those of local communities along the supply chain

- Positive/negative impact on consumers

- Positive/negative impact on trade

- Positive/negative impact on the economy (EU/third country).

Please explain: