Finance Watch
Making finance serve society

President Ursula von der Leyen
Vice-President Věra Jourová
Vice-President Maroš Šefčovič
Commissioner Didier Reynders
Commissioner Thierry Breton

European Commission
Rue de la Loi / Wetstraat 200
1049 Brussels, Belgium

Brussels, 15th December 2021

Subject: Concerns over the future and level of ambition of a legislative proposal on sustainable corporate governance

Dear President von der Leyen,
Dear Vice-President Jourová,
Dear Vice-President Šefčovič,
Dear Commissioner Reynders,
Dear Commissioner Breton,

We are writing to you on behalf of Finance Watch and its members to express support for the European Commission work on a legislative proposal on sustainable corporate governance, but also to raise concerns over the second rejection of the impact assessment for the proposal by the Regulatory Scrutiny Board (RSB). We believe that the level of ambition of the future proposal should not be reduced as a result of this rejection.

We are particularly concerned over the reasons for the rejection of the impact assessment. The RSB should use clear evidence-based reasons for rejecting impact assessments related to legislative proposals. This should not turn into an exercise of assessing how likely different stakeholders are to support a proposal, but rather focus on regulatory impact analysis and evaluation. If the impact assessment has been rejected due to pressure from industry stakeholders with arguments rather than evidence, this poses serious concerns and risks breaking citizens' trust in the process. Clarity over the reasons for rejecting the impact assessment is needed at this point to ensure the integrity of the process and the RSB is intact.

A legislative proposal to incorporate sustainability in corporate governance is indispensable to set the incentives and obligations for companies to transition towards a sustainable economy. Without this initiative, the European Union risks falling short of its objective to transition to a sustainable and inclusive economy that works for people.

An ambitious EU legal framework should require companies to integrate sustainability considerations within corporate strategies, business models, decision-making and oversight. This must be underpinned by a clear duty of directors to pursue long-term, sustainable value creation.

It is crucial that sustainability risks are not only identified and disclosed, but that they are effectively managed. Therefore, companies should be obliged to set measurable sustainability targets, including transition pathways and decarbonisation plans to meet those targets. The Commission strategy released in July 2021 mentions development of a guidance to support voluntary pledges and references the related disclosure obligations in the proposal for a Corporate Sustainability Reporting Directive. However, experience shows that voluntary initiatives are ineffective. Disclosure requirements alone will not do the job unless underpinned by a clear obligation for companies to set targets in their corporate strategies.

The European legal framework lags behind when it comes to corporate responsibility for identifying, mitigating and preventing harm in its group-wide operations and through value chains. The OECD Guidelines for Multinational Enterprises, UN Guiding Principles on Business and Human Rights, constitute a robust framework. However, despite a ten year-anniversary celebrated this year by these voluntary initiatives, the world continues to witness widespread environmental harm and violations of worker and human rights.

Therefore, an ambitious EU legal framework for corporate due diligence through corporate operations and global value chains should oblige companies to identify, mitigate and address the adverse impacts of corporate operations on people and the planet. Due diligence rules would also inform the consideration of sustainability risks, opportunities and adverse impacts by the management and at board level. The legislative initiative should consider the role that directors must play to ensure that the corporate due diligence is embedded throughout corporate operations and strategies.

Rules can only deliver on their objectives as long as they are properly enforced. Therefore, we strongly support the Commission's intention to ensure effective enforcement of rules through civil liability and supervision by administrative authorities. In addition, an effective judicial framework should enable all parties to seek legal remedies.

A key context to this proposal is the short-termism that can be seen in capital markets. Equity holding periods have been steadily decreasing since 1975[1]. Already back in 2012, Professor John Kay singled out short-termism as an important problem in capital markets, mentioning in his report that examples of short-term behaviour in capital markets are easy to find[2].

To lengthen the time-horizons of business and investment decisions, appropriate incentives should be set. To that end, we recommend that a proportion of corporate executive and non-executive directors' variable remuneration should be linked to corporate sustainability targets.

This proposal is of paramount importance to enable the European Union to deliver on its climate, environmental and social objectives. We therefore call on the Commission to keep the initial level of ambition and live up to its commitments for a well-balanced and effective proposal.

We would like to draw your attention to the proposals we contributed to the public consultation on an Initiative on Sustainable Corporate Governance and in a joint briefing that we compiled with other NGOs.

We would like to thank you for your attention and consideration of the points we raise.

Best regards,

Benoît Lallemand
Secretary General

Thierry Philipponnat
Head of Research and Advocacy

[1] Sources: Bolton P and Samama F. "Loyalty-Shares: Rewarding Long-term Investors" Journal of Applied Corporate Finance, Volume 25, page 75 (Summer 2013); https://www.reuters.com/article/us-health-coronavirus-short-termism-anal-idUSKBN24Z0XZ; Kleintop, J. (2012), "What the Fed Can't Do", LPL Financial Research, Weekly Market Commentary, 6 August, www.emeraldhost.net/files/LPL/Research/Copy%20of%20WMC_WhattheFedCantDo_RES%20 3794%20080612.pdf.