



ICGN

International Corporate Governance Network

ICGN Comment Letter

8th February 2021

European Union (EU) sustainable corporate governance consultation

Introduction

The International Corporate Governance Network (ICGN) is pleased to comment on the European Union's (EU) sustainable corporate governance consultation.

Led by investors responsible for assets under management in excess of US\$54 trillion, the ICGN is a leading authority on global standards of corporate governance and investor stewardship. Our membership is based in more than 40 countries and includes companies, advisors and other stakeholders.

ICGN's mission is to promote high standards of professionalism in governance for investors and companies alike in their mutual pursuit of long-term value creation contributing to sustainable economies world-wide. ICGN has long been active in promoting good corporate governance in the EU¹, and our investor members, many of whom are domiciled in the EU, hold significant debt and equity positions in European companies.

¹ ICGN Comment Letter on the European Shareholder Rights Directive (November 2014):

https://www.icgn.org/sites/default/files/EC%20-%2004.11.2014_0.pdf

ICGN Comment Letter on Capital Markets Union Green Paper (May 2015):

<https://www.icgn.org/sites/default/files/European%20Commission%202015.pdf>

ICGN Comment Letter on European Commission's public consultation on institutional investors and asset managers' duties regarding sustainability (January 2018):

<https://www.icgn.org/sites/default/files/1.%20ICGN%20Comment%20HLEG%20Consultation.pdf>

ICGN Comment Letter Consultation Document on the Update of the Non-Binding Guidelines on Non-Financial Reporting (March 2019):

<https://www.icgn.org/sites/default/files/ICGN%20comment%20to%20EU%20Non-financial%20Reporting%20Consultation%20March%202019.pdf>

ICGN Response to the European Commission consultation on the review of the Non-Financial Reporting Directive (June 2020)

<https://www.icgn.org/sites/default/files/9.%20ICGN%20Response%20to%20the%20European%20Commission%20consultation%20on%20the%20review%20of%20the%20Non-Financial%20Reporting%20Directive.pdf>

We applaud the EU for its global leadership in promoting sustainable finance as a matter of good corporate governance and investor stewardship. As a global investor body, ICGN shares with the European Union EU a common interest in promoting sustainability in the corporate governance processes of companies in Europe and globally. ICGN also shares the EU's desire to promote long-term perspectives by both companies and investors, with a focus on sustainable value creation. In this context we welcome the EU's policy initiative to explore how to better integrate sustainability in how companies are managed and governed.

We have followed how the current EU consultation on sustainable corporate governance developed from the EY study on sustainable corporate governance which was published in July 2020-- and which led to the subsequent Sustainable Corporate Governance Impact Assessment. We understand that the EY study is the main basis of evidence and the intellectual foundation supporting the proposals under consideration in this consultation.

However, we are aware that this EY study is subject of criticism by several credible academic commentators² including the Harvard scholars Mark Roe, Holger Spamann, Jesse Fried, and Charles Wang. These commentators identified the following flaws:

- Inappropriate conflation of sustainability with time horizons: the study was fundamentally ill-designed.
- Inapposite evidence-- for example the methodology for interpreting the effects of share buybacks is flawed.
- Biased use of research literature that support the report's position without sufficiently engaging contrary literature.
- Ill-considered reform proposals.

We share these concerns. From this foundation we are further concerned that the EU is considering far reaching changes to director duties and legal requirements relating to the governance of sustainability that have an insufficient—or at least an unconvincing-- basis in evidence.

With regard to the consultation questions themselves, we are further concerned by multiple choice answers that do not appropriately reflect how we would respond to the questions. There is also a clear bias in some of the questions—we site question 8 as an example below—which betrays a bias that shareholders are axiomatically focused on their own short term interests as opposed to the long-term success of the company. Of the US \$54 trillion

² See the European Corporate Governance Institute webinar on the EY study (November 2020): <https://www.youtube.com/watch?v=TbFo861KCUg>

Also see written critiques by:

Harvard Law and Business School Professors Mark Roe, Holger Spamann, Jesse Fried, Charles Wang The European Commission's Sustainable Corporate Governance Report: A Critique (17 Nov 2020) Available at ECGI: <https://ecgi.global/working-paper/european-commissions-sustainable-corporate-governance-report-critique>

Alex Edmans, London Business School (1 October 2020): <https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12548-Sustainable-corporate-governance/F556360>

Vanessa Knapp, Queen Mary University of London (7 October 2020) <https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12548-Sustainable-corporate-governance/F584014>

managed by ICGN's investor members, a substantial majority of this is to support pension and retirement savings. This provides ICGN and its members with a long-term time horizon. So we challenge this incorrect, and unfair, short termist generalisation.

As much as we support, and share, the EU's vision of fostering sustainability in the governance of companies, we do not believe that the true governance of sustainability can be legislated for through government fiat any more than ethics can. Many of the proposals under consideration in this consultation could be effective mechanisms to promote the governance of sustainability. But these would be best positioned a on a principles basis, possibly in the form of a comply or explain voluntary code of corporate governance—not as a matter of hard law.

However, as we have seen with the EU's Non-financial Reporting Initiative, mandatory disclosures can play a positive role in promoting better governance practices. We would be supportive of mandatory disclosure requirements with regard to the governance of sustainability, and believe this may be a more effective way to bring action towards achieving sustainable corporate governance than the tactics currently under consideration.

In responding to this consultation, we have drawn upon some of the latest revisions to ICGN's own Global Governance Principles ("ICGN Principles") which will be updated this year as part of a three-year review process.³ Many of the revised Principles focus on the sustainable success of companies and long-term value creation. This means a commitment to legitimate shareholder expectations for returns on capital while maintaining positive relations with relevant stakeholders, including employees, customers, suppliers, and society more broadly. This requires companies and investors to focus on, not only aspects relating a preserving and building a company's financial capital, but factors impacting human and natural capital too.

Note: ICGN comments to the consultation below are highlighted in italics and the responses to multiple choice questions are highlighted in yellow.

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

Questions 1 and 2 below which seek views on the need and objectives for EU action have already largely been included in the public consultation on the Renewed Sustainable Finance Strategy earlier in 2020. The Commission is currently analysing those replies. In order to reach the broadest range of stakeholders possible, those questions are now again included in the present consultation also taking into account the two studies on due diligence requirements through the supply chain as well as directors' duties and 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

³ First published in 2001, the ICGN Global Governance Principles set out global investor expectations on high standards of corporate governance. ICGN Members often default to the ICGN Principles as a bellwether for their voting policies and company engagements. The Principles also serve to inform regulators on internationally accepted governance standards and inspire the evolution of national codes around the world:

<https://www.icgn.org/policy/global-governance-principles>

climate change. Do you think companies and their directors should take account of these interests in corporate decisions alongside financial interests of shareholders, beyond what is currently required by EU law?

- Yes, a more holistic approach should favour the maximisation of social, environmental, as well as economic/financial performance.
- Yes, as these issues are relevant to the financial performance of the company in the long term.
- No, companies and their directors should not take account of these sorts of interests.
- Do not know.

As investors with a fiduciary duty to generate sustainable returns for beneficiaries we have sympathy with the holistic approach but our immediate priority is on a company's sustainable value creation and financial performance. Companies and their directors should also take account of all environmental and social factors that may materially impact companies' value creation, both in the near term and the long term. They also should identify key negative impacts their businesses have on the environment and society, and develop programmes to minimise these negative impacts, irrespective of their financial materiality. Where negative externalities produced by the business (e.g. climate change, environmental pollution, human rights abuse in the supply chain) occur and their mitigation would materially affect companies' financial health, directors should develop a strategy of addressing these over a specified timeframe, and disclose this information to shareholders, creditors and other key providers of capital to the company.

Corporate profits and investors returns achieved without taking account of the actual costs to the environment and society will not be sustainable in the future as such negative externalities are being or are likely to be priced in. The identification of, and a strategy for, minimising negative externalities at this stage will not only contribute to environmental and social sustainability, but will help companies to reduce compliance costs in future.

We believe that companies and their directors should take these issues into consideration as part of the process of management and governance. However, while provisions of this nature might be appropriate for a code of corporate governance, extending this degree of prescription to hard law or regulation would be problematic and could result in box-ticking, confusion or other unintended consequences.

New references in the ICGN Global Governance Principles related to stakeholder interests clarify that boards should ensure that the corporate culture facilitates constructive stakeholder relations, particularly company employees, linked to the board's oversight of human capital management.

There is also new reference that the board is accountable for the governance of sustainability in the company and its integration with company strategy, operations and risk oversight, including the effectiveness of the company's policies and practices as related to governance, environmental and social factors. In this way ICGN's agenda is very complementary to the EU's goal of enhancing sustainable corporate governance.

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?

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

While we agree that these matters to consider for companies and boards as part of the management/board oversight process, we caution against prescriptively codifying how this best be done. Again, this may be more a matter of a code of corporate governance than hard law regulation.

The COVID19 pandemic has emphasised the need for companies to understand, monitor and have an appropriate degree of control over their supply chains. Global supply chains have become too complex, often involving too many tiers to be successfully monitored by companies, whether large or small. This has in turn created plentiful opportunities for human rights abuses, poor environmental and health & safety standards and practices in the supply chains.

Companies and boards should establish full visibility and a comprehensive due diligence/continuous monitoring of supply chains. This could help to improve environmental performance and social practices, as well as help companies improve resilience of their supply chains. There is certainly a risk that some companies may decide to reduce complexity of their supply chains and bring them closer to home, thus reversing in part the globalisation and offshoring trends of the past decades.

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

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

Section 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?

- The interests of shareholders - Relevant
- The interests of employees - Relevant
- The interests of employees in the company's supply chain – Relevant (to a lesser degree)
- The interests of customers - Relevant
- The interests of persons and communities affected by the operations of the company - Relevant
- The interests of persons and communities affected by the company's supply chain – Relevant (to a lesser degree)
- The interests of local and global natural environment, including climate - Relevant
- The likely consequences of any decision in the long term (beyond 3-5 years) - Relevant
- The interests of society - Relevant
- The interests of creditors - Relevant

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?

These may all be worthy practices, certainly worth considering, but not hardwiring into hard law.

ICGN's Global Governance Principles have been revised with strengthened emphasis that directors have a fiduciary duty to act in good faith with due care and loyalty to promote the long-term success of the company for sustainable value creation. Implicit in this concept is the need to have regard to key stakeholder interests, while generating returns on capital for shareholders.

We recommend that the EU reviews the UK's approach to incorporating stakeholder considerations as part of Section 172 of the Companies Act. This emphasises the need of

the board to be cognisant of relevant stakeholder interests when taking decisions to promote the long-term success of the company.

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, i.e. 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

The intent is good and is a practice that we also encourage as a matter of the governance process. But this is too prescriptive for hard law or regulation.

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
- No response

This is a very poorly worded question and betrays a bias of shareholders being axiomatically focused on their own short term interests as opposed to the long-term success of the company. That characterisation is both unfair and incorrect. As written this question is really not appropriate to answer with the choices presented, so we abstain-- and we believe that you will have difficulties in meaningfully interpreting responses to this question.

As corporations are commercial enterprises, they should seek to make profits and deliver fair returns to their owners – shareholders, as well as fulfil their obligations to other providers of capital. Understanding and finding a sustainable balance of interests of all relevant stakeholders in a company (e.g. shareholders, creditors, employees, suppliers, customers, communities, regulators, etc.) is simply part of managing a for-profit enterprise, but this is not something that should be prescribed.

There will inevitably be situations where conflicts will arise between the interests of different stakeholder groups. For example, a conflict may arise between the interests of shareholders and employees in the event of a restructuring deemed essential to reduce the company's cost base; similarly, a conflict may arise between the interests of customers and employees, whereby technological developments could reduce the cost of products for customers, while resulting in job losses for employees. It is possible for conflicts to arise between different interests of the same stakeholder group – e.g. greater automation of production process often improves health & safety of employees, but often costs jobs. A legal requirement for directors to balance the interests of all stakeholders could impact the abilities of companies to take business decisions in a timely manner or lead to higher costs of doing business.

It is important that corporate directors act in the long-term interests of the company, understand the impacts that their decisions will have on key stakeholders and seek to minimise these impacts. We would suggest a formulation that is similar in nature to Section 172 of the UK Companies Act, which defines director duties as promoting the long-term success of the company itself, for the benefit of its owners, while having regard for material stakeholder interests. It is implicit in this concept that sustainable success requires companies to find an acceptable, and sustainable, balance of stakeholder interests. But seeking to prescribe this balance would most likely create confusion unnecessarily.

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?

As noted above, prescribing this duty of care is unnecessary and could create confusion and prompt unintended consequences. We do not believe the case has been made that this change is required and there is no evidence we are aware of which would lead us to believe that introduction of a new director's duty of care will achieve the intent lying behind this initiative.

How could these possible risks be mitigated?

Whatever change introduced should be positioned as a principles-based best practice, not as a change in law.

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

Shareholders are not opposed to integrating stakeholder interests in management decisions. Quite the opposite, it is in the interests of shareholders that companies take stakeholder interests into account as support and goodwill of key stakeholders has proven to increase stability, reduce business risks, and enhance corporate returns. However, there is a difference between integrating stakeholder interests in business decisions, and a legal requirement to balance the interests of all stakeholders.

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

This should be positioned as a best governance practice, not as a hard law requirement-- though this may be an area where a disclosure requirement could be employed usefully.

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:

No. There are, however, many examples of engagement between shareholders and directors on the topics concerning the interests of other stakeholders in the company, including sanctioning of directors via shareholder votes.

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:

N/A

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?

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

The enforcement of directors' duty of care should be a responsibility of either the company's owners (i.e. shareholders) who can appoint or remove directors, or a regulator. Other stakeholders should be able to draw attention to potential violations of the directors' duty of care, including through dedicated formal channels, but they should not have a direct role in the enforcement of directors' duties.

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.

N/A

Section 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.

We disagree with the definition insofar as it refers to a legal requirement. But as a matter of prudent management we agree that companies should have adequate processes to identify, mitigate and prevent to the extent possible negative environmental and social impacts in their supply chains; however, it is critical for implementation that the regulation focused on “reasonable efforts”, and required a risk-based, proportionate and context specific approach. This would help reduce costs and align additional supply chain due diligence efforts with the scope, scale and impacts of the companies’ business activities.

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”:** We discourage a more prescriptive 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.).
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- **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 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

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?

Not in favour with combining Option 1 with sector or thematic approaches.

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.

A principles-based approach that would suggest key process practices for supply chain due diligence as described under Option 1 could create more clarity for companies, while also providing flexibility to focus on environmental and social risks and impacts that are most relevant for the sector and individual companies depending on the nature of their businesses and the structure of their supply chains. Furthermore, this is the only option that is consistent with the “reasonable efforts” requirement and a risk-based, proportionate and context specific approach set out under Question 14 that we agree with.

We do not see an immediate need for complementary guidance, although case studies and examples from the existing body of research highlighting best practice approaches could be helpful to companies and investors.

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

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?

N/A

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?

N/A

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

N/A

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

N/A

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 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

As per our response to Q15, a principles-based approach should apply to all companies, and not only SMEs. It is important that due diligence criteria applied to SMEs as they do have supply chains (both onshore and offshore) and are often more complicit in negative environmental and social impacts in their supply chains than larger enterprises. However, SMEs do have much less resources to dedicate to supply chain due diligence and require some assistance.

The best way to help SMEs without sacrificing the quality of supply chain due diligence is to create an EU-level database where findings from supplier due diligence by enterprises operating in the EU is collected and available to all registered companies. This would include results from supply chain audits undertaken by larger companies, any issues highlighted by civil society representatives in respect of specific suppliers, as well as supplier self-assessments, including policies, certifications and inspection reports. Database should work on the membership basis, whereby all members would commit to contribute findings from own supply chain due diligence. Larger corporate members may be asked to pay an administrative fee for using the database (which should be small given that they will likely be main contributors of information), while SMEs should have access fees either waived or covered by EU funding. Companies operating outside the EU should be allowed to become members and contributors as well. This type of collaboration already exists at the industry level within and outside the EU, but a larger scale initiative is needed to successfully tackle supply chain issues.

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
- 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.

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

N/A

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

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

Though we do not support this (and would encourage a focus on disclosure instead), we believe a national supervision, with EU coordination would be most workable.

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
- No

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?

Section 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**
- I strongly disagree
- I do not know
- I do not take position

There should be no prescription as regards the companies' and boards of directors' approach to incorporating stakeholder interests and sustainability considerations into corporate strategy and companies' due diligence processes. Any requirement to "establish and apply mechanisms" will likely translate into prescriptive mechanisms and structures either at the EU or at national levels, which will lead to more bureaucratic and compliance driven approaches and reduce the effectiveness of the regulation. To be effective, each company must follow the approach that best suits its circumstances and its governance structures. The focus should be on the desired outcomes and not on prescriptive processes.

However, we would be supportive of stronger disclosure requirements by companies with regard to issues including company purpose, sustainability and stakeholder relations.

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

N/A

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	<input checked="" type="radio"/>	<input type="radio"/>

Stakeholder general meeting	<input type="radio"/>	<input type="radio"/>
Complaint mechanism as part of due diligence	<input checked="" type="radio"/>	<input type="radio"/>
Other, please specify	<input type="radio"/>	<input type="radio"/>

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 (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)

- 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) - **5**
- Regulating the maximum percentage of share-based remuneration in the total remuneration of directors - **1**
- Regulating or limiting possible types of variable remuneration of directors (e. g. only shares but not share options) - **3**
- Making compulsory the inclusion of sustainability metrics linked, for example, to the company's sustainability targets or performance in the variable remuneration - **4**
- 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 - **4**
- Taking into account workforce remuneration and related policies when setting director remuneration - **6**
- Other option, please specify – **7**
- None of these options should be pursued, please explain – N/A

All the attempts to regulate executive remuneration has so far resulted in unintended consequences. A more effective solution might be to have a system of a binding vote on the executive remuneration policy and an advisory vote on the annual remuneration report. This would sharpen the accountability of management to structure remuneration in a responsible

and sustainable way. Direct shareholding in the company at a level and over a time period that aligns economic interests of the management with those of long-term shareholders should be most effective way of achieving the alignment of interests. A requirement that executive directors build their shareholding by buying shares in the market rather than getting them allocated by the company for free would add to the alignment of interests between executives and shareholders by creating a downside risk for executives that is currently missing from most share-based remuneration plans.

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 (Study on directors' duties and sustainable corporate governance).

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

Again, this should not be a requirement, but simply a matter of prudent governance. If there is to be any formal requirement of those presented in this consultation this one is probably the least problematic. But it should not be prescribed. A role of a director is multidimensional and, to achieve best results, should be fulfilled by people whose skills and expertise span a number of areas deemed essential for the success of the company and for quality oversight at the board level. For this reason, it is dangerous to create requirements for a specific skillset as this might lead to boards being populated by subject matter experts who lack the broader expertise and skills needed for effective decision-making. While all corporate boards should be well versed in sustainability topics of relevance to their companies, this knowledge and expertise can come from different channels, including regular trainings, advisory bodies, direct interaction with key stakeholders, broadening of the directors' induction programmes to include sustainability issues, etc.

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. (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
- 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?

We are concerned that your positioning on share buybacks is based on confused and flawed research.⁴ Share buybacks certainly can be abused, but they can also be useful tools in capital management. Rather than introduce legislation relating to share buybacks that might inhibit legitimate uses of buybacks you might consider is a disclosure requirement relating to capital allocation policy. This would address the company's policy towards a range of important—and discretionary—practices. This would certainly include share buybacks, but could also extend to dividend policy, capital spending/R&D and how the company funds itself with an appropriate balance of debt and equity. This looks at the buyback issue holistically, which is essential if we are to differentiate between buybacks which are legitimate as opposed to short termist. There may be scope, however, in reviewing the extremes of existing practices, such as the possibility for a share buyback authorisation of 100% of issued capital. We may also wish to suggest a supermajority vote of 2/3 for AGM authorisations to repurchase shares if less than 50% of the capital is represented at the AGM (as is also the requirement for authorising the board to exclude pre-emption rights.

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

The consultation on sustainable corporate governance ignores the role that other financial stakeholders in the company, such as for example bondholders and other creditors, can play. Governance and capital management are critical parts of credit analysis. Active bond investors closely monitor capital allocation of companies in their portfolios and would be the critical (and often first) stakeholder group to sound an alarm when shareholder rewards (either via dividends or share buy-backs) are seen as too high and unsustainable in the long-term, detrimental to the future financial or competitive position of the company, or driven by inappropriate structures and incentives in the executive remuneration policies. At the same time bondholders have much more limited access to the boards and senior management of companies compared to equity holders. While the UK and Japan Stewardship Codes are actively encouraging bondholder engagement, there has not been much appetite from boards/senior management of companies to proactive seek views of bondholders on these important topics. An explicit mention of bondholders among critical stakeholder groups and an encouragement of a regular dialogue between companies and bondholders in the same way as is currently the case for shareholders could go a long way to correct the unsustainable capital management practices without the need for further regulation.

⁴ See the critique by Harvard Law and Business School Professors Mark Roe, Holger Spamann, Jesse Fried, Charles Wang The European Commission's Sustainable Corporate Governance Report: A Critique (17 Nov 2020) Available at ECGI: <https://ecgi.global/working-paper/european-commissions-sustainable-corporate-governance-report-critique>

Section 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.

N/A

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).

N/A

We hope these comments are helpful with regard to your deliberations on these matters. Please contact ICGN Policy Director George Dallas if you would like to discuss this in further detail: george.dallas@icgn.org

Yours sincerely,



Kerrie Waring
Chief Executive

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