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The European Commission
Directorate-General for Justice and Consumers
Unit for Company Law
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Response to the European Commission's roadmap on sustainable corporate governance

With reference to the ongoing possibility to submit feedback in relation to the European Commission's initiative Sustainable Corporate Governance and the related EY study on director's duties (the "**Report**"), the undersigned Swedish Institutional Owners Association (the "**Respondents**") would like to submit the following statement.

The Respondents have signed the **Joint response to the European Commission's roadmap on sustainable corporate governance** sent by the Swedish Corporate Governance Board and many others.

The Respondents would like to emphasize that they share the Commission's underlying objectives, fighting climate change and promoting human rights must certainly be top priorities for the European Union and each of its member states.

However, as investors in the global markets, we do not see short-termism in the market as problematic as the Report assert. This is well expressed in a report from Stockholm Sustainable Finance[1] "An ideal market will always include a mix of investors with different investment time horizons and investment strategies. An individual investor also needs to balance their overall portfolio across a mix of short, medium and long-term strategies. While there is also a role for short-term analysis and short-term holdings on the financial market, it becomes problematic when analysis unduly overlooks outcomes that occur far in to the future. When short-term priorities hinder long-term value creation, or when long-term risk is overlooked due to an excessive focus on short-term horizons, then we have a problem. Short-term and long-term considerations can co-exist; however, short-termism at the expense of fulfilling fiduciary duties creates the concern."

[1] https://www.stockholmsustainablefinance.com/ssfc-report-pdf/

The EY Report proposes a number of changes to the company law rules or corporate governance models of the Member States pertaining to the composition and duties of boards of directors of limited liability companies with a view to reducing what is referred to as short termism in corporate governance and contributing to a sustainable development. The Report defines "short termism" as the ratio between, on one hand, a company's pay-outs in terms of dividends and share buybacks and, on the other hand, the company's net income. The higher the ratio, the greater the short termism since the distributed funds should have, according to the Report, instead been reinvested in the company. The Report is wholly devoid of reasoning on the critical interaction between the supply of risk capital and the dynamics of the business sector or, expressed another way, regarding the role played by the capital market in allocating and re-allocating resources. Dynamism and innovation in businesses requires the avoidance of lock-in effects. One example is the Oil and gas sector which is designated as one of the most short-term oriented sectors in the Report. For climate reasons, it is obvious that the sector should decrease in size over the next 20-30 years. High dividends and share buy-backs in the sector is therefore a sign of long-term action. The prospects of competitive yields are fundamental to the ability of companies to attract risk capital from what is today a global capital market.

In addition, funds must be re-allocated from companies that lack profitable investment alternatives to forward-looking companies with profitable projects. This is a profoundly central function in a dynamic and sustainable economy. Many small and medium sized companies are in need for capital to develop. As is often recognized these companies are crucial both for innovation and the creation of new jobs. Institutional owners provide capital to small and medium sized companies but depend on pay-outs from other investments to enable this. Institutional owners typically reinvest dividends and other pay-outs on a regular basis. Since these investors are integrating sustainability into their investment processes, in particular European investors, capital will be re-allocated and will support the transition into a sustainable European economy.

In the initiative for a European capital market union, other parts of the EU Commission have expressed concern for the lack of efficient supply of risk capital in Europe. This does not bode well with the new initiative by DG JUST, which will create increased uncertainty amongst owners as regards the condition governing the contribution of risk capital to European companies and additionally undermine corporate access to capital for forward-looking investments. This would be particularly serious at this juncture when recovery from the COVID-19 crisis demands our ability to strengthen the balance sheets of European companies with additional equity capital from the market if Europe is not to continue falling behind the rest of the world in areas such as digital platforms, life sciences and artificial intelligence – industries that require more, and not less, access to risk capital.

1. *Directors' duties and company's interest are interpreted narrowly and tend to favour the short-term maximisation of shareholders' value :*
    - We would like to point out false assumptions like : *« In addition, the national regulatory frameworks in the 12 Member States tend to link the concept of directors' duties and company's interest with short-term objectives»*. Quite the contrary – the aim for long-term success of the company – is embedded in the legislation of some Member States.

2. *Growing pressures from investors with a short-term horizon contribute to increasing boards' focus on short-term financial returns to shareholders at the expense of long-term value creation :*

- In general, the Commission should refrain from reforming legislative texts whose adoption remains recent (Cf. Shareholders Rights Directive 2, SRD2). The credibility of the European legislative system and the bureaucratic overload for companies are at stake.
- Furthermore, in SRD2, the basic idea was to counteract short-termism by giving shareholders greater opportunities and incentives to influence companies through active corporate governance. In this Report, the underlying thought seems to be the opposite. Short-termism should be counteracted by reducing the owners' influence on the companies. As long-term and active institutional owners, the Respondents are convinced that it is better to give the owners greater opportunities to influence the companies.
- Institutional owners have a long-term investment horizon. We are active and engaged as owners, much more so than those investors that have a shorter investment horizon. It is not our experience that companies generally are oriented towards short-term results. That companies strive to be profitable and remain attractive for investors, should not be confused with short-termism – it is a pre-requisite for economic sustainability. Without this, no transition will come about.

3. *Companies lack a strategic perspective over sustainability and current practices fail to effectively identify and manage relevant sustainability risks and impacts.*
    - There is a strong trend where more and more companies are integrating sustainability into their business strategies often by demand from institutional owners. This is evident in e.g. the increasing number of companies adopting Science Based Targets or a growing appetite for methods for meaningful impact-reporting (e.g. Global Compact-GRI joint initiative). And moreover, this will be further enhanced with a number of ongoing initiatives launched under the EU Action Plan for Sustainable Finance – e.g. the Taxonomy and the review of the NFRD.
    - The survey lacks a common definition of what is meant by sustainability. This can vary from one sector to another.

4. *Board remuneration structures incentivise the focus on short-term shareholder value rather than long-term value creation for the company*
    - The statement is not based on facts. The situation regarding the links of remuneration and sustainability issues is rapidly changing. Many companies include ESG criteria in their remuneration programs for senior executives, a development that is encouraged by many institutional owners.
    - Besides, board remuneration is usually built on fixed fees. Executive directors may have variable remuneration.

5. *The current board composition does not fully support a shift towards sustainability.*
    - While acknowledging the need for diversity on the board to allow meaningful perspectives, including sustainability, we strongly argue against prescriptive competence requirements. The need for different competences, generalists and specialists, shift over time and depends on the company's current and desired outlook
    - We questions the feasibility of a recommendation that would request Member States « to ensure that sustainability-related expertise is systematically considered in the board nomination process of companies (M5.2) ». Legislative acts require a minimum

of clarity, and yet another compulsory requirement as contemplated here could only result in a sterile box-ticking exercise.
- For natural reasons the legislator does not and should not define the competence of directors. The situation of a company changes over time, at the same time the required competence of the board members changes.

6. *Current corporate governance frameworks and practices do not sufficiently voice the long-term interests of stakeholders*
    - In order for companies to have an opportunity to survive in the long term, the board must balance between the company's stakeholders.
    - It should also be recalled that current law and practice in many European countries does give a wider access to stakeholders (especially employees) to corporate governance.

7. *Enforcement of directors' duty to act in the long-term interest of company is limited*
    - We would like to question this assumption : « If EU were not to act, current enforcement levels of directors' duty of care in Member States can be expected to remain low, in line with the existing trend ».
    - Contrary to what the report states, there are cases of enforcement. This can be discovered with fact finding from insurers. There are not infrequently cases where directors liability is enforced.
    - The report states that « there are neither provisions of company law nor self-regulatory measures which expressly allow the stakeholders of a company to instigate legal proceedings on behalf of the company to sue its directors for not having taken the stakeholder interests into account as part of their duty of care». We wish to warn about the excesses of such provisions. There is a great risk of diluting the energy of the directors in lawsuits where each stakeholder who feels aggrieved by a decision could take legal action. Stakeholders have diverging interests, and the role of boards of directors is largely a balancing act to arbitrate between these. The European Commission should think twice before changing the accountability rules. Such provisions would clearly lead to the creation of risk-averse companies in Europe.

The report concludes by outlining certain policy implications of the study pertaining to legal interventions by the EC.

The Respondents agree with the ambitions expressed in the EU Action Plan. However, we argue that harmful short-termism is not as prevalent as suggested and have shown that the proposals in the Report will not serve to counteract harmful short-termism. In some cases, the proposals will lead to box-ticking exercises without any effect. In other cases, the proposals are very far-reaching and may severely damage the competitiveness and dynamism of European listed companies. We are convinced that other components of the EU Action Plan are better suited to influence companies in a more sustainable direction.