



## **Legislative initiative of the European Commission on sustainable corporate governance: public consultation. International Bulletin, February 2020.**

The EU's goal of becoming the first emission-neutral continent by 2050, as well as meeting the sustainability goals of the 2030 Agenda and the European Green Deal, have led the European Commission (EC) to consider the integration of sustainability into the legislative framework that regulates corporate governance. The reason is that many companies still persist in achieving short-term goals to the detriment of long-term development and sustainability considerations.

Integrating sustainability into corporate governance means encouraging companies to make long-term decisions taking into account environmental (including climate and biodiversity), social, human and economic impacts rather than favouring short term gains.

The EC's various policies and Action Plan stress the integration of sustainability into the governance of companies to promote recovery after the COVID-19 pandemic and improve their resilience, and the prevention and management of risks, dependencies and damage, including those occurring in the supply chain.

This initiative is part of the EC work plan for 2021. It will complement the objectives of Social Europe and the revision of Directive 2014/95/EU on disclosure of non-financial information. Specifically, it will establish behavioural obligations that correspond to the disclosure obligations established in the Directive. Furthermore, information on the application of sustainability requirements in the governance of companies and on compliance by their managers with their obligations will allow the various stakeholders to monitor these aspects, and this in turn will force companies to take responsibility for how they mitigate adverse social and environmental impacts.

The initiative takes as a reference international standards such as the UN's Guiding Principles on Businesses and Human Rights and the OECD's Guidelines for Multinational Enterprises and Due Diligence Guidance for Responsible Business Conduct.

The initiative also considers SMEs that have been particularly affected during the pandemic by delays in payments from large companies, which underlines how important it is for boards of directors to take account of the interests of employees throughout the entire spectrum of the distribution and supply chain, as well as of those affected or involved in its operations.

### **Preparatory work**

Prior to the public consultation, the EC carried out two studies, following the recommendations of the High Level Group of Experts and the 2018 Action Plan, to study the obstacles to a transition to a sustainable economy and their causes. These studies are the following:

1.- On directors' duties and sustainable corporate governance. It has been observed that in the last 30 years

there has been a tendency for listed companies to favour the achievement of short-term shareholder benefits to the detriment of the long-term interests of the company. The data indicate an increasing trend regarding payments to shareholders that have gone from 20% to 60% of net income, while the ratios of capital expenditure and R&D spending to net income have decreased by 45% and 38% respectively.

Legal systems and market practices are indicated as the causes.

Consequently, the study recommends a modification of the legislation with three specific objectives: 1) to strengthen the role of directors in achieving long-term business goals, 2) to improve managerial accountability for integrating sustainability factors into decision-making and business strategy, and 3) to encourage business practices that contribute to the sustainability of the company.

2.- On due diligence requirements throughout the supply chain. This study is based on the analysis of due diligence procedures to address adverse sustainability impacts by identifying and preventing significant risks and mitigating negative impacts. According to the information presented in the study, only one in three companies considers all human rights and environmental impacts in its due diligence processes.

It is clear that voluntary actions are not sufficient to encourage good practices and, according to the study, there is significant support from stakeholders to establish binding legislative requirements.

The regulation that is established should benefit companies, facilitating legal certainty and equal opportunities as well as protection in the event of litigation. The study reveals that some Member States have already begun to regulate this issue, which can fragment the market, put the single market at risk and increase costs for companies. It is preferred that the legislative initiative be transversal in nature, rather than developing specific regulatory frameworks for each sector of activity.

## **EC public consultation**

On 26 October 2020 the EC opened a public consultation period that ended on 8 February 2021. In this consultation, stakeholders were invited to answer several questions aimed at ascertaining their opinion on the establishment of a European legal framework regulating the obligations of the governing bodies of a company regarding the integration of sustainability considerations in the governance of the company and the favouring of decision-making considering the interests of the company in the long term.

The consultation is structured in five sections dedicated to the following topics:

- Need for and objectives of an EU intervention regarding sustainable corporate governance, based on the reasons explained above.
- Duty of diligence of directors and interests of stakeholders. In almost all Member States there is an obligation for the directors of a company to act for the benefit of the company, but it is an obligation that is formulated in such a way that it is not clear what its purpose is. This lack of clarity contributes, the EC argues, to decision-making considering the short term to the detriment of the long term and to a very narrow interpretation of the obligation, basically focused on the interests of the shareholders without considering other stakeholders.
- Due diligence obligation. The obligation of the company to have adequate procedures to prevent, mitigate and assume responsibilities regarding impacts on human rights (including labour rights and conditions), health and the environment (including climate change) should be considered both in the company's operations and its supply chain. It must also be based on the company's risks, in a proportionate manner, and take into account the specific context, according to the EC consultation.
- Other elements. The EC also consults on what and how the involvement of stakeholders should be, the remuneration of executives, the improvement of knowledge about sustainability within the board of directors

and share buy-back programmes.

- Consequences of the possible measures adopted in the company itself, that is, what the administrative costs, legal costs and the improvements in productivity, competitiveness, risk management, resilience, innovation, etc. would be.

It is expected that the EC, after examining and considering the responses received to the consultation, will publish a legislative initiative in the spring of 2021 with the aim of establishing a binding regulatory framework that establishes the obligation to introduce sustainability factors in business management that are common to the whole EU and give greater weight to the consideration of the long term in making decisions that affect the company.

**Useful link:**

[Public consultation and roadmap](#)