On behalf of the Public Affairs Executive (PAE) of the EUROPEAN PRIVATE EQUITY AND VENTURE CAPITAL INDUSTRY

8 February 2021

Response to the European Commission's Consultation Document Proposal for an Initiative on Sustainable Corporate Governance

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

Background:

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 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?

Please choose between: (only one option possible)

- **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.**

Answer:

Yes, as these issues are relevant to the financial performance of the company in the long term.

Please provide reasons for your answer (maximum 5,000 characters).

Answer:

Firstly, we would like to highlight the fact that shareholder value is an inherently long term concept, in particular for private equity, where the shareholders are per definition long term investors.

Furthermore, we believe that favouring a broad range of issues to be taken into account alongside financial interests, rather than to incorporate these considerations in the long term value creation for the companies and their shareholders, would risk leading to an inconsistency in actually addressing such important issues and diffusing the directors' responsibilities both in the short, medium and long term.

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?

Please choose between: (only one option possible)

- 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.

Answer:

Yes, an EU legal framework is needed.

Please explain (maximum 5,000 characters).

Answer:

If the EU were to move in this direction, then a **framework/guidance** is preferred as a first step. However, a “hard-law” requirement runs the risk of becoming too standardized and burdensome in a first instance. Increased transparency from firms around these issues could instead be a better and potentially self-regulative action. With deeper requirements as a potential next step if there is limited positive development.

In line with the above, such a framework should apply to all companies, but with lighter minimum requirements for SMEs, including SMEs backed by private equity and venture capital fund managers. It should be practical and not disproportionally burden smaller companies. Proportionality assessment based on size, capabilities and risk exposures, and resource availability are the two key criteria in this context. It is crucial to recognise that smaller companies may have limited supply chain options and limited scope to orchestrate change.

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? (multiple choice)

Answer:

	Yes/No
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	Yes
Contribute effectively to a more sustainable development, including in non-EU countries	Yes
Levelling the playing field, avoiding that some companies freeride on the efforts of others	Yes
Increasing legal certainty about how companies should tackle their impacts, including in their value chain	Yes
A non-negotiable standard would help companies increase their leverage in the value chain	No
Harmonisation to avoid fragmentation in the EU, as emerging national laws are different	Yes
SMEs would have better chances to be part of EU supply chains	No
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? (multiple choice)

Answer:

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

Section II: Directors' duty of care – stakeholders' interests

Background:

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?

Answer:

	Relevant	Not relevant	I do not know/I do not take a 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			
other interests, please specify			

Question 6 - Do you consider that corporate directors should be required by law (1) to 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, and (3) to identify the opportunities arising from promoting stakeholders' interests?

Answer:

	I strongly agree	I agree to some extent	I disagree to some extent	I strongly disagree	I do not know	I do not take a 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 (maximum 5,000 characters)**.**

Answer:

We find it very worrying that it is unclear whether stakeholders' interests would be weighted equally with those of shareholders and, if so, how directors are expected to resolve conflicts between various stakeholder and shareholder constituencies. It needs to be clear that, by default, the job of the directors is to maximise the success of the company (and for most solvent commercial companies the best way to measure that is long term shareholder value), not maximise the benefit for any particular stakeholder group. It is, of course, always open to companies to set an objective for the company other than shareholder value maximization.

If directors can be held to account by outsiders, it would create significant uncertainties and risks, with directors apparently having no clear yardstick by which to judge the merits of any decision. This would risk diluting directorial accountability – when directors are accountable to all kinds of stakeholders, with no clear prioritisation, they will in reality be accountable to none.

Private equity backed companies design corporate governance structures that hold management to account and incentivise long term value creation - attempts to impose mandatory rules could undermine the effectiveness of this model.

Finally, we believe that the duties related to stakeholders' interests should be the duties of the companies and not only of the directors, even though they carry it out on behalf the companies.

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?**

Please choose between: (only one option possible)

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

Answer:

I disagree to some extent.

Please explain (maximum 5,000 characters).

Answer:

As long as it is clear what companies are required to do, and as long as the requirements are proportionate (especially for SMEs), we do not think it is objectionable per se to ask directors to put in place procedures to manage risks to stakeholders. However, we believe that this question is more related to the duties of the companies. We do agree with the principle of requiring companies to understand and mitigate significant negative impacts, but this obligation should not be imposed on individual directors.

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?**

Please choose between: (only one option possible)

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

Answer:

I strongly disagree.

Please provide an explanation or comment (maximum 5,000 characters)**.**

Answer:

This question builds on the false dichotomy that shareholders would value a more short term approach than other stakeholders. Shareholder value is an inherently long term concept, in particular for private equity, where the shareholders are per definition long term investors.

Directors should be encouraged to build long term sustainable value, and in order to do that they will have to take account of all stakeholder interests. However, this is not a "balancing" of interests; instead it is identifying how stakeholder interests contribute to (and, conversely, how failure to take account of them could damage) long term value and then acting accordingly.

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? (maximum 5,000 characters)

Answer:

We find it very worrying that it is unclear whether stakeholders' interests would be weighted equally with those of shareholders. If directors can be held to account by outsiders, it would create significant uncertainties and risks, with directors apparently having no clear yardstick by which to judge the merits of any decision. This would risk diluting directorial accountability - when directors are accountable to all kinds of stakeholders, with no clear prioritisation, they will in reality be accountable to none.

How could these possible risks be mitigated? Please explain. (maximum 5,000 characters)

Answer:

Long term success and long term shareholder value should be the goal and directors have to think about all of the inputs that will contribute to that, and engaged stakeholders are clearly an important part of that.

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

Please choose between: (only one option possible)

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

Answer:

I agree to some extent.

Please explain. (maximum 5,000 characters)

Answer:

We agree in principle, but what really matters is how this is encouraged, required and enforced. Directors' duties are not, in our view, the right or most effective way.

Enforcement of directors’ duty of care

Background:

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 13 - Do you consider that stakeholders, such as 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 choose between: (only one option possible)

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

Answer:

I strongly disagree.

Please explain your answer. (maximum 5,000 characters)

Answer:

Giving stakeholders a role in the enforcement of directors’ duty of care would put directors in a very difficult position when faced with hard decisions. This would also encourage a litigation culture, stifle entrepreneurial decision-making, encourage defensive decision-making (especially if directors have no clear yardstick by which to judge decisions, as we elaborate further in our answer to Question 6) and discourage people from wanting to act as directors. Finally, it could prejudice other (especially less well-organised and/or well-funded) stakeholders.

Section III: Due diligence duty

Background:

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 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. (maximum 5,000 characters)

Answer:

This definition seems reasonable to us. This answer should be read in conjunction with our answers to Questions 15 and 15g.

Question 15 - Please indicate your preference as regards the content of such possible corporate due diligence duty (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:

- **Options 1, 2 and 3 are horizontal, i.e. cross-sectorial and cross-thematic, covering human rights, social and environmental matters. They are mutually exclusive.**
- **Options 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.

Answer:

	Yes/No (only 1 option possible)
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.	No
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.	No
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.	No
Option 4 - "Sector-specific approach": The EU should continue focusing on adopting due diligence requirements for key sectors only.	No
Option 5 – "Thematic approach": The EU should focus on certain key themes only, such as for example slavery or child labour.	Yes
None of the above, please specify.	

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. (maximum 5,000 characters)

Answer:

A framework/guidance is preferred as a first step. A "hard-law" requirement runs the risk of becoming too standardized and burdensome in a first instance. Increased transparency from firms around these issues could instead be a better and potentially self-regulative action. With deeper requirements as a potential next step if there is limited positive development.

Question 15g - If you ticked option 5) in Question 15, which themes do you think the EU should focus on? (maximum 5,000 characters)

Answer:

Basic human rights and recognized ILO labour rights. Beyond this, other themes should be sector specific.

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

Answer:

	Yes/No (multiple choice possible)
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	X
Micro-enterprises (less than 10 people employed) should be excluded	X
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	X
Capacity building support, including funding	
Detailed non-binding guidelines catering for the needs of SMEs in particular	X
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. (maximum 5,000 characters)

Answer:

A framework should apply to all companies, but with lighter requirements for SMEs, including SMEs backed by private equity and venture capital fund managers. It should be practical and not disproportionally burden smaller companies. Proportionality assessment based on size, capabilities and risk exposures, and resource availability are the two key criteria in this context. It is crucial to recognise that smaller companies may have limited supply chain options and limited scope to orchestrate change.

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?

Please choose between:

- **Yes**
- **No**
- **I do not know**

Answer:

I do not know.

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 (multiple choice)**?**

Answer:

	Yes/No
Judicial enforcement with liability and compensation in case of harm caused by not fulfilling the due diligence obligations	No
Supervision by national competent 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 fines)	No
Supervision by national competent authorities (option 2) with a mechanism of EU cooperation/coordination to ensure consistency throughout the EU	Yes
Other, please specify	

Please provide explanation. (maximum 5,000 characters)

Answer:

A framework/guidance is preferred as a first step. A “hard-law” requirement runs the risk of becoming too standardized and burdensome in a first instance. Deeper requirements as a potential next step if there is limited positive development.

Section IV: Other elements of sustainable corporate governance

Question 20 - Stakeholder engagement

Background:

Better involvement of stakeholders (such as 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?

Please choose between: (only one option possible)

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

Answer:

I disagree to some extent.

Please explain. (maximum 5,000 characters)

Answer:

Accepting that stakeholder views matter, it is self-evident that directors have to take steps to know what they are, and it is not unreasonable to ask them to explain how they have done that. However, to require specific methods seems rigid and constraining and could actually risk being counterproductive to having directors taking relevant steps beyond the minimum requirements.

Question 20b - If you agree, which stakeholders should be represented? Please explain. (maximum 5,000 characters)

Answer:

Those that the directors have identified as being important for the company's success.

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

Answer:

	Is best practice	Should be promoted at EU level
Advisory body		
Stakeholder general meeting		
Complaint mechanism as part of due diligence		
Other, please specify	Depends on the stakeholders	

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)

Answer:

	Ranking (1 to 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)	
Regulating the maximum percentage of share-based remuneration in the total remuneration of directors	
Regulating or limiting possible types of variable remuneration of directors (e.g. 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	
Requirement to include carbon emission reductions, where applicable, in the lists of sustainability factors affecting directors' variable remuneration	
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	X

Please explain. (maximum 5,000 characters)

Answer:

There is no evidence suggesting that share ownership in private equity contributes to a short term focus - in fact, quite the opposite is likely to be the case. In this regard, we would like to highlight the alignment of interest and long term focus that the private equity model involves; in particular lower salaries and bonus, and more focus on long and medium term share-based incentives.

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 (multiple choice)**.**

Answer:

	Yes/No
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	X

None of these are effective options	

Please explain. (maximum 5,000 characters)

Answer:

All of or none of the suggested requirements may be effective options, it depends entirely on the individual company. Therefore, it is important to clarify what types of companies would be subject to these measures. We presume that the above list of potential requirements is only for larger companies with significant climate change related impacts. If any of the requirements above could be universally relevant it would be the obligation for the board to assess level of expertise. This however is already inherently a directors and board obligation and further requirements may not add much.

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?

Please choose between: (only one option possible)

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

Answer:

I do not take a position.

Contact

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About the PAE

The Public Affairs Executive (PAE) consists of representatives from the venture capital, mid-market and large buyout parts of the private equity industry, as well as institutional investors and representatives of national private equity associations (NVCAs). The PAE represents the views of this industry in EU-level public affairs and aims to improve the understanding of its activities and its importance for the European economy.

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