CORPORATE GOVERNANCE AND ESG DISCLOSURE IN THE EU

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CFA Institute

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The mission of CFA Institute is to lead the investment profession globally by promoting the highest standards of ethics, education, and professional excellence for the ultimate benefit of society.

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1. Executive Summary

Corporate governance and the integration of environmental, social, and governance (ESG) factors in organizations' investment analysis and decisions are key developments that CFA Institute Advocacy division has been following closely in recent years. Advocating for the development of efficient corporate governance and closely monitoring the evolving role of ESG information in the investment process are key activities for CFA Institute. In 2016, we published the report "Corporate Governance Policy in the EU,"[1] in which we looked at the main governance issues in the EU, and gave recommendations to the key players involved in the reshaping of better European corporate governance practices to provide greater transparency and corporate accountability as well as to ensure maximized value for interested parties. As several legislative and nonlegislative measures, including the Shareholder Rights Directive II (SRD II) and numerous sustainable finance initiatives, have been introduced in the EU in the past four years, we decided to update our previous report to focus on the unaddressed problems that investors still face on the governance side, and on the impact that the recent initiatives on ESG disclosure may have had on the industry and investors.

Sustainability and corporate governance practices are constantly evolving in the EU. Several measures have been put in place in the EU with the objective of encouraging the integration of ESG factors in the investment process of organizations, while ensuring, at the same time, investor protection and adequate shareholder rights. The Covid-19 crisis, which highlighted that important investor protection issues are still present, could be seen as an opportunity for regulators, companies, and investors to improve corporate governance standards and increase their focus on social and environmental interests, which should be embedded into business strategies. Policymakers' willingness to initiate a shift to more sustainable processes is clear, and the current crisis is likely to accelerate this transition.

The impact of the implementation of more sustainable strategies is inevitable as this immediately will translate into social and financial costs for organizations and investors. The proposed logic, however, is that such practices could create greater value for both shareholders and society in the long term.

Following the publication of our 2016 report on corporate governance, this new project aims to identify the governance mechanisms in Europe that still do not offer sufficient

[1] See CFA Institute, "Corporate Governance Policy in the EU," 2016, https://www.cfainstitute.org/-/media/documents/article/position-paper/corp-gov-policy-in-european-union-through-investor-lens.ashx.

corporate accountability and protection of shareholder rights and to analyze the effects of embracing ESG in EU companies' business models. It is fundamental not to penalize shareholder interests when looking to satisfy stakeholder needs.

1.1 Key Recommendations

- We are particularly concerned about the scarce level of protection that is ensured to minority shareholders. We encourage EU and national regulators to further improve the rules on the exercise of shareholder rights and accountability for minority investors.

- We discourage the practice of differential ownership rights across the EU.

- We urge the European Commission to focus, especially in light of the ongoing revision of the Non-Financial Reporting Directive (NFRD), on the inconsistencies between the EU legislations on disclosure of ESG and nonfinancial information to enhance clarity and avoid misinterpretations from organizations and investors. The definition of materiality needs to be reinforced to ensure its intended purpose. Moreover, clear and consistent language between the Sustainable Finance Disclosure Regulation (SFDR) and the Taxonomy Regulation would help investors have a better understanding.

- EU companies could be further encouraged to increasingly include stakeholders' interests, and to establish a longer-term horizon in their investment decision-making process to contribute to the ultimate benefit of society, which is an aim embedded in our mission statement.

- Firms should build a more effective and consistent dialogue and engagement process with shareholders to ensure that board directors, management, and investor needs are better aligned. This effort should be monitored by national supervisors and at the EU level, using a scoreboard of comparison to enable supervisory convergence.

- Investors also should be more proactive in the engagement process to actively influence company's decisions.

- If virtual or hybrid annual general meetings (AGMs) will continue to be held in the future, after gathering restrictions are lifted, organizations should address practical and technical barriers that thus far have prevented shareholders from effectively exercising their rights.

2. Introduction

CFA Institute is the global association of investment professionals that sets the standard for professional excellence and credentials. The organization is a champion of ethical behavior in investment markets and a respected source of knowledge in the global financial community. Our aim is to create an environment in which investors' interests come first, markets function at their best, and economies grow. There are more than 178,000 CFA® charterholders worldwide in 162 markets. CFA Institute has nine offices worldwide and 159 local member societies.

CFA Institute held three virtual workshops, between May and July 2020, with ESG and corporate governance practitioners in Europe: a roundtable with experts from EU member states from north-central Europe, one with participants representing southern Europe, and one with practitioners from the United Kingdom. Such discussions helped provide the necessary input for this report. Most of these individuals had participated in the roundtables that served as input for the 2016 report. We also would like to thank the workshop participants, whose names are shown at the end of this manuscript.

This report intends to portray how ESG developments and corporate governance policies may merge into new regulatory frameworks aimed at strengthening the link between companies and the wider society, which includes shareholders and other stakeholders.

In Section 3, we highlight the main legislative measures that the EU and the United Kingdom have introduced on sustainable finance, including measures to improve nonfinancial reporting, and corporate governance.

Section 4 examines the current issues that may curb the development of ESG integration in the EU. The problems that have been discussed in the three workshops and that are analyzed in the report mainly concerned the absence of shared views on the definition of sustainability between regulators and investors (and between investors in various regions of Europe), the nontransparency of relevant governance practices, the inconsistencies in the language of different EU legislations, and the potential effects of the recent ESG disclosure requirements under the SFDR.

Section 5 focuses on corporate governance approaches that have been adopted in Europe and the current issues that have emerged in the recent years, especially in light of the application of the SRD II rules.[2] This section includes an analysis of the comply-or-explain mechanism and how this is applied by European corporations, the practices that do not guarantee sufficient protection to minority shareholders, and the evolving approach toward company employees (particularly after the outbreak of the coronavirus crisis).

In Section 6, we examine how European regulators and organizations have reacted to the impossibility of holding in-person AGMs, given the restrictions that the majority of European governments put in place in response to the pandemic.

In Section 7, we look at development in the UK corporate governance practices, including corporate purpose and viability reporting.

In our final section, Section 8, we present three action memoranda for European policy-makers, companies, and investors. These include relevant recommendations for the development of better corporate governance standards and practices in Europe.

[2] For more details, see the Directive (EU) 2017/828 on the encouragement of long-term shareholder engagement (Shareholder Rights Directive II), 17 May 2017, https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32017L0828&from=EN.

3. Legislative Background

Since CFA Institute published the 2016 "Corporate Governance Policy in the EU" report, the EU has undertaken several initiatives to foster more ESG-related investments.

Sustainable investing was initially but a mention in the context of the European Commission Action Plan on Capital Markets Union (CMU), which was launched in 2015. Significant legislative developments on ESG investing have occurred since the beginning of 2018, starting with the final report from the High-Level Group on sustainable finance. The European Commission set up the expert group, composed of individuals from civil society, academia, and the financial sector, with the aim of looking at possible policy actions that could be taken by European legislators to encourage capital flows toward sustainable investments.

The Commission followed the recommendations from the High-Level Group report[3] by launching a broad Action Plan[4] and putting forward three legislative proposals on sustainable finance. These proposals, which have been enshrined in EU law, include a regulation on sustainability-related disclosures in the financial services sector (i.e., the SFDR),[5] a regulation on the establishment of a framework to facilitate sustainable investment (i.e., the Taxonomy Regulation),[6] and a regulation on EU Climate Transition Benchmarks (i.e., the EU Paris-Aligned Benchmarks) as well as sustainability-related disclosures for benchmarks.[7]

In this report, we focus in particular on the impact of the main disclosure rules under the SFDR and the Taxonomy Regulations. The SFDR requires financial market participants and investment advisers to publish information on their policies related to the integration of sustainability risks in their investment decision-making process or in their investment advice on their websites. Information must specify where the market participant or adviser

[3] See the EU High-Level Expert Group on Sustainable Finance, "Financing a Sustainable European Economy," Final Report 2018, https://ec.europa.eu/info/sites/info/files/180131-sustainable-finance-final-report_en.pdf.
[4] See the European Commission, "Action Plan: Financing Sustainable Growth," 8 March 2018, https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52018DC0097&from=EN.
[5] See the Regulation (EU) 2019/2088 on sustainability-related disclosures in the financial services sector, 27 November 2019, https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:02019R2088-20200712&from=EN.
[6] See the Regulation (EU) 2020/852 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088, 18 June 2020, https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32020R0852&from=EN.
[7] See the Regulation (EU) 2019/2089 on EU Climate Transition Benchmarks, EU Paris-aligned Benchmarks and sustainability-related disclosures for benchmarks, 27 November 2019, https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32019R2089&from=EN.

considers principal adverse impacts of investment decisions on sustainability factors and clear reasons in cases in which these impacts are not taken into account. A statement on due diligence policies with respect to these principal adverse impacts must be produced as well.

The Taxonomy Regulation also includes specific disclosure rules for financial products, with or without sustainability objectives. The scope of the Taxonomy Regulation applies to all financial market participants that make available financial products.[8] To comply with the Regulation, all financial products covered need to disclose the extent to which their investments are aligned with the Taxonomy. This means that all financial products marketed in the EU are subject to the Taxonomy and its environmental objectives. Products that are promoting an ESG objective one way or another must disclose a description of how and the extent to which they are invested in sustainable activities (defined in the legislation), including details on the respective proportions of enabling and transitional activities. The Taxonomy's backbone is constituted of screening criteria which are meant to determine which and how economic activities are to be considered Taxonomy compliant. This approach is based on the notion that compliant economic activities should contribute to one of the following six environmental objectives: (1) climate change mitigation, (2) climate change adaptation, (3) sustainable use and protection of water and marine resources, (4) transition to a circular economy, (5) pollution prevention and control, and (6) protection and restoration of biodiversity and ecosystems. At the same time, these activities cannot significantly harm any one of the other five objectives.

At the time of writing, the European Commission has been focusing on its renewed sustainable finance strategy as the EU is looking at ways to accelerate the green transition in the financial sector. This is part of the European Green Deal, which is one of the current Commission's priorities and the main strategy to align future EU growth with sustainability objectives.

The revision of the NFRD, the EU's framework requiring large undertakings (with more than 500 employees) to publish social and environmental information related to their activities, is also under way. Under the current directive, large public interest firms, such as large listed companies, banks, and insurance companies, must include a report on nonfinancial information in their annual statement. The NFRD covers four sustainability issues: environment, social and employee issues, human rights, and bribery and corruption. Under

[8] Financial market participants and financial products within the scope of the Taxonomy Regulation are defined under the SFDR. They broadly cover all firms and products that are within the scope of, notably, the Markets in Financial Instruments Directive (MiFID), Solvency, the Alternative Investment Fund Managers Directive (AIFMD), and the Undertakings for the Collective Investment of Transferable Securities (UCITS).

the scope of the legislation, firms are required to also disclose information about their business model and other related policies to the company business.[9]

Finally, the NFRD has a double materiality perspective: companies should inform not only how sustainability issues impact the firm but also how the company activities affect society and the environment.[10] Double materiality also applies to the disclosures, which are required under the SFDR, concerning the impact and the risks that an investment has on sustainability factors and vice versa.

With regard to the timeline for the application of these European rules, the majority of the disclosure requirements (e.g., about financial market participants' and advisers' policies on the integration of sustainability risks, consideration of the adverse sustainability impact of investment decisions, and the description of products with environmental and social characteristics or with a sustainable investment objective) under the SFDR will enter into force on 10 March 2021. The publication of adverse sustainability impact become mandatory on 30 June 2021 for entities with more than 500 employees. Disclosure is required at a product level both on websites and in precontractual documents. Six European supervisory authorities (ESAs) Regulatory Technical Standards (RTS)[11] related to the content, methodologies, and presentation of sustainability-related disclosures were submitted to the European Commission in December 2020, and the ESAs plan to submit another RTS on sustainability indicators in relation to adverse impacts in the field of social and employee matters, respect for human rights, anticorruption, and antibribery matters to the Commission by 30 December 2021.

The Taxonomy Regulation will be applicable as of 1 January 2022 for the rules related to climate change mitigation and adaptation, whereas the rules concerning the other four environmental objectives will enter into force on 1 January 2023. In November 2020, the European Commission issued a public consultation on a draft delegated on two sets of technical criteria for the definition of economic activities that contribute to climate change mitigation and adaption activities and that avoid causing significant harm to the other

[9] For more details, see the EU Directive 2014/95 amending Directive 2013/34/EU as regards disclosure of nonfinancial and diversity information by certain large undertakings and groups, 22 October 2014, https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014L0095&from=EN.

[10] See European Commission, "Guidelines on Non-financial Reporting: Supplement on Reporting Climate-Related Information," 20 June 2019, https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52019XC0620(01)&from=EN#:~:text=They%20should%20also%20consider%20the,(3)%20comprehensive%20but%20concise%3B.

[11] See the ESAs public consultation including the proposed RTS on content, methodologies, and presentation of disclosure under the SFDR; ESMA, "Joint ESA Consultation on ESG Disclosures," 23 April 2020 to 1 September 2020, https://www.esma.europa.eu/press-news/consultations/joint-esa-consultation-esg-disclosures.

environmental objectives. A delegated Regulation is necessary to clarify the activities that are covered by the Taxonomy.[12]

Following a public consultation, which the European Commission launched in the first half of 2020,[13] a proposal on the revised NFRD is expected to be put forward in the first quarter of 2021.

3.1 OECD Guidelines on Responsible Conduct

The Organization for Economic Cooperation and Development (OECD) has been steering for a long time responsible business practices, increased corporate responsibility, and respect of human rights. In 1976, the OECD already had adopted a Declaration on International Investment and Multinational Enterprises. The declaration included guidelines to ensure that company operations were aligned with government policies, to strengthen the mutual confidence between organizations and society, and to contribute to increased sustainable developments from multinational firms. The guidelines also included recommendations on the incorporation of risk-based due diligence into the organizational areas in which business operations interact with society.

The OECD most recently reviewed these in 2011. The implementation of the recommendations is based on a particular mechanism — that is, the adhering governments (all 37 OECD member countries and 13 non-OECD member countries) commit to promote the guidelines, through their network of National Contact Points for Responsible Business Conduct, and to help solve issues that arise from specific instances, such as a nonjudicial grievance mechanism.

In 2018 the OECD issued the Due Diligence Guidance for Responsible Business Conduct, which offers practical support to firms on the steps needed to fully implement the Guidelines for Multinational Enterprises. The main sections of this guidance are analyzed in the next section.

[12] For more details on this initiative, see European Commission, "Sustainable Finance — EU Classification System for Green Investments," 2020, https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12302-Climate-change-mitigation-and-adaptation-taxonomy.
[13] See the European Commission public consultation on the NFRD revision, "Nonfinancial Reporting by Large Companies (updated rules), 2020, https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12129-Revision-of-Non-Financial-Reporting-Directive/public-consultation.

3.2 Shareholder Rights Directive II

The SRD II is the EU framework on the protection of shareholders and their rights. The directive, which was adopted in 2017, amends the previous SRD with the objective of increasing transparency and protection of shareholders and encouraging long-term remuneration as well as companies' focus on corporate governance and shareholder engagement.

SRD II introduced new requirements on remuneration of directors; identification of shareholders; easier exercise of shareholders' rights; transmission of information; and transparency for institutional investors, asset managers, and proxy advisers, and related party transactions.

With regard to the remuneration rules, organizations should prepare a remuneration policy, which would be subject to shareholders' binding vote.[14]

SRD II gives the right to companies to identify their shareholders that own at least 0.5% of their shares. Intermediaries are required to communicate, without any delay, all of the necessary information for shareholders so that they can easily exercise their rights.

Institutional investors and asset managers also must develop an engagement policy describing how they integrate shareholder engagement in their investment strategy. They also need to disclose, and make accessible free of charge, information on how their engagement policy has been implemented, an explanation of the most important votes in general meetings, how they have cast votes when they hold shares of the company, and the use of proxy advisers' services.

Institutional investors are required to publicly disclose how their equity investment strategy contributes to the medium-long-term performance of their assets.

Proxy advisers should indicate the code of conduct they apply and report on the verification of its enforcement. They also should publicly disclose, at least annually, information on the preparation of their research and advice and the reasoning behind their voting recommendations. They must identify and disclose potential conflicts of interest.

SRD II rules entered into force in two stages. The majority of requirements were implemented by member states in June 2019. The measures on identification of shareholders, and easier exercise of shareholder rights, came into force on 3 September 2020.

[14] However, member states can provide, under the directive, for the vote on remuneration policy to be only advisory.

Under the new CMU action plan,[15] the European Commission is planning to introduce new measures to facilitate cross-border investor engagement. Currently, because of the diversity of national frameworks on company laws that are present in the EU, cross-border investors are prevented from exercising their voting rights. The Commission will propose a single definition of shareholder and further harmonize rules on the interaction between investors, intermediaries, and issuers. These proposals are expected to be presented not earlier than the third quarter of 2023.

3.3 Sustainable Corporate Governance

A new Sustainable Corporate Governance initiative is expected to be presented by the European Commission in the first quarter of 2021. These measures follow up on the Communication on the European Green Deal, which established the objective of encouraging the inclusion of sustainability into corporate governance frameworks and stimulating long-term and sustainable company policies.

Through this legislative initiative, the European Commission explicitly aims to better align long-term interests of shareholders and stakeholders, including company employees and society. To achieve this goal, organizations should be motivated to establish long-term horizons in their investment decisions and business strategies and be able to resist the short-term pressure from shareholders who may be looking for immediate value creation. The objective would be to reach a more balanced business approach. Company boards are called on to consider all of the relevant interests for long-term sustainability of the firm or stakeholders, and organizations should consider all adverse sustainability impacts of their investment decisions and take measures to mitigate the negative effects.[16]

In early September 2020, the European Parliament published its own initiative draft report on sustainable corporate governance to influence the preparation of the Commission's legislative proposal. The report emphasizes that companies should actively contribute to sustainability because their response to social and environmental challenges could affect their long-term performance, resilience, and, in extreme cases, survival. The organization's

[15] See the European Commission, "A Capital Markets Union for People and Businesses — New Action Plan," 24 September 2020, https://eur-lex.europa.eu/resource.html?uri=cellar:61042990-fe46-11ea-b44f-01aa75ed71a1.0001.02/DOC_2&format=PDF.

[16] For more details, see a summary and the impact assessment on the initiative; European Commission, "Sustainable Corporate Governance," 2020, https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12548-Sustainable-corporate-governance.

strategy should not only be based on measures for the short-term maximization of shareholders' wealth but also related to sustainability issues.[17]

The European Parliament suggests that companies set up advisory committees to facilitate the inclusion of relevant interests of shareholders, employee representatives, and other external stakeholders in the definition and monitoring process of a company's strategy.

3.4 Developments in the United Kingdom

The UK Stewardship Code,[18] which was published by the Financial Reporting Council (FRC) in 2012, is probably the best example of stewardship codes in the world. This is a voluntary manual encouraging firms and institutional investors to adopt better practices in their engagement with other parties and to contribute to the improvement of long-term risk-adjusted returns to investors. After a substantial review by the FRC, a new code[19] was adopted and came into force on 1 January 2020. The new code, which is seen as a big improvement on the previous version, sets up 12 principles for asset owners and managers. These owners and managers are accountable for their responsibility to ensure effective stewardship and cannot delegate this responsibility.

Important developments have also occurred in the field of non-financial reporting as the Financial Conduct Authority put forward, at the end of 2020, a new proposal for the promotion of better disclosure on how UK premium-listed companies (including sovereign-controlled commercial companies) are managing climate-related risks and opportunities. Under the Authority's proposal, such firms will be required to produce carbon reporting or explain if they have not done so.[20] Recently, the UK government's Department for Workplace Pensions (DWP) also proposed to require, within the next three years, 85% of pension funds in the UK to report on their carbon footprint.

With the withdrawal of the United Kingdom from the EU, which became effective 1 February 2020 and will have its effects at the end of the transition period after

[17] For details, see the European Parliament, "Report on Sustainable Corporate Governance" (2020/2137(INI)), 2 December 2020, https://www.europarl.europa.eu/doceo/document/A-9-2020-0240_EN.pdf.
[18] See the Financial Reporting Council, "UK Stewardship Code," September 2012, https://www.frc.org.uk/getattachment/d67933f9-ca38-4233-b603-3d24b2f62c5f/UK-Stewardship-Code-(September-2012).pdf.
[19] See the Financial Reporting Council, "UK Stewardship Code," 2020, https://www.frc.org.uk/getattachment/5aae591d-d9d3-4cf4-814a-d14e156a1d87/Stewardship-Code_Dec-19-Final-Corrected.pdf.
[20] See the Financial Conduct Authority's proposals to enhance climate-related disclosures by listed issuers and clarification of existing disclosure obligations 2020 https://www.fca.org.uk/publication/policy/ps20-17.pdf

31 December 2020, the UK policy on corporate governance and ESG may diverge from the current EU framework and strategy. Despite sharing the EU goal to channel public and private investments to the transition toward a green economy, the United Kingdom may decide to adopt its own rules on the classification of sustainable activities and therefore not implement the technical standards of the Taxonomy Regulation that would make the framework operational.

4. ESG Corporate Disclosure

4.1 Lack of Consensus on the Definition of ESG Characteristics

Key statement: "A lack of consensus on the absolute classification of ESG characteristics is inevitable as ESG encompasses dynamic concepts, which are subject to broad interpretations."

ESG characteristics are increasingly embedded in company business model. Around the world, companies have developed their own ESG policies, yet significant variations remain and measuring the seriousness with which they are enforced continues to be a difficult task.

An important obstacle to a greater development of ESG practices in the EU is the lack of a single view on the definition of ESG and sustainability. Practitioners in our workshops remarked that although EU regulators seemed to have converged toward a common definition of what can be considered sustainable, European investors and market participants still have contrasting opinions on the definition of ESG. A lack of consensus on the absolute classification of ESG characteristics is inevitable as ESG encompasses dynamic concepts, which are subject to broad interpretations. Divergence of views in terms of materiality are still relevant. For example, some firms may deem that certain climate or environmental aspects are not material, whereas others may believe that they are. This difference on materiality explains why a standardization of ESG factors remains difficult.

A practitioner from the north-central European workshop stressed that more focus should be placed on the intention of taking environmental and social aspects into account as well as its measurability. Intention, which should be made explicit by providers and advisers, needs to be measurable to show how much the aimed E and S factors have been considered into a financial product.

Industry experts from the UK group emphasized that investors first should agree on a common definition of the goal to be achieved. This could include contributing to reach a specific social or environmental target, or a certain amount of returns per unit of ESG risk. After agreeing upon this, a consensus on how to define ESG factors can be found more easily.

Highlight 1: The Future of Sustainability in Investment Management

CFA Institute recently issued the new Future of Finance thought leadership reporting on "The Future of Sustainability in Investment Management." This study looks at how sustainable investing will be further developed in the future as well as its impact on the investment management industry and investors.

Six actions are needed to have an effective transition toward the increased adoption of sustainable investing practices and greater impact of sustainable investing:

1. ESG education: organizations should provide training to build ESG expertise and ensure that ESG thinking is embedded in all investment settings;

2. system-level thinking: firms should be more active in integrating ESG and sustainability into their investment models;

3. collaboration theory: organizations need to increasingly focus on stewardship and commit more resources to ownership duties and opportunities;

4. ESG data: these practices can help companies reduce the obstacles they have faced when managing large datasets; professionals should better understand the materiality and validity of ESG information;

5. sustainability innovation: commitment to sustainability innovation includes better incentives, organizational agility, and iteration; these come from all parties; and

6. purposeful culture: organizations should have a stronger fiduciary culture. Positive ethics and values are part of companies that have a purposeful culture and a mission-driven ethos.

Source: CFA Institute, "Future of Sustainability in Investment Management: From Ideas to Reality," https://www.cfainstitute.org/-/media/documents/survey/future-of-sustainability.ashx.

4.2 Disclosure of Governance Practices

Key statement: "Greater transparency of corporate governance practices is necessary for investors."

Practitioners from all our roundtables agreed that greater transparency of corporate governance practices is necessary for investors. Any takeover measure that companies put in place should be clearly disclosed. These are typical defense measures that large organizations, in particular, may adopt to prevent possible hostile bids. These also include caps on voting rights and any deviation from the one-share, one-vote principle.

Other important elements to be reported should concern the independence of nonexecutive members of the board of directors, and whether the chief executive officer (CEO) also operates as chair of the organization. In addition, the functioning and the operations within the audit committee of the supervisory board should be made public. This information is extremely relevant to better understand whether the audit committee can interact, without any interference from the board, with the internal audit and finance department of the company. External auditors also find this data valuable in their audit review and in case of fraud investigation. Moreover, data on the audit committee is fundamental to looking at whether a firm's internal controls are effective and whether they are running properly as their possible malfunctioning can negatively affect the company and its investors. Furthermore, clear disclosure on the functioning of external auditing and the remuneration paid to auditors would help investors have a better understanding of the external auditing process and to ascertain that this is independent and transparent.

A participant from the north-central European workshop highlighted that the German Corporate Governance Code now recommends increased disclosure of corporate governance information for German firms, which not only should provide details of the structure of the organization's supervisory board but also publish the background for each proposed board member, including their curriculum vitae, relevant knowledge, skills, and previous professional experiences.[21]

Another practitioner from the same group argued that organizations should disclose their credit rating profile given that potential investors usually consider this information when assessing companies' risk profiles and portfolio weighting.

[21] For more details, see European Corporate Governance Institute, "German Corporate Governance Code 2019," 16 December 2019, https://ecgi.global/node/7493,

Highlight 2: OECD Due Diligence Guidance on Responsible Business Conduct

In 2018, the OECD adopted its new Due Diligence Guidance on Responsible Business Conduct with the aim to support organizations on the implementation of the OECD Guidelines for Multinational Enterprises (2011) by providing clear explanations of its due diligence recommendations and associated provisions. The OECD defines Responsible Business Conduct as the integration, within the core of businesses, of the management of risks to the environment, people, and society. By putting an effective due diligence mechanism in place, businesses should be able to remediate the adverse impacts that they generate or contribute to causing.

Among the OECD guidelines, relevant areas include disclosure, human rights, environment, and consumer interests.

The disclosure recommendation calls companies to be transparent in all their operations and responsive to increasingly sophisticated public demands for information.

On human rights, the OECD remarks that firms have an impact on all internationally recognized human rights. Given that, organizations are required to meet their responsibilities.

The recommendation on environment is for multinational enterprises to raise their environmental performance and maximize their contribution to environmental protection through improved internal management and better planning.

Regarding consumer interests, organizations are called to apply fair business, marketing, and advertising practices and to ensure the quality and reliability of the products that they provide.

Source: OECD, "OECD Due Diligence Guidance for Responsible Business Conduct," 2018, http://mneguidelines.oecd.org/OECD-Due-Diligence-Guidance-for-Responsible-Business-Conduct.pdf.

We also asked whether due diligence across supply chain should be included in the companies' disclosures. Usually, it is in businesses' interest to conduct a detailed due diligence and disclose as much information as possible to reduce perceived risks. A participant from the roundtable representing north-central Europe stressed that due diligence is usually more thorough in private investment markets and is also often performed in emerging markets. Challenges emerge, however, when due diligence also should be conducted across the supply chain. Because the EU lacks a proper legal framework on disclosure of due diligence practices across the supply chain, the only way for investors to get this information could be to improve communication and engagement with their company and to press management to conduct due diligence across the supply chain. The latter practice would bring more clarity on organizations' key suppliers and better hold people accountable.

Highlight 3: European Commission Study

In January 2020, the European Commission published a study on due diligence requirements through the supply chain. The study, which is based on many surveys, case studies, and interviews with EU businesses, highlights that stakeholders experience disadvantages from the current lack of regulation and that they would expect the introduction of an appropriate EU law. Several possible regulatory options (e.g., no policy change, voluntary guidelines, new rules requiring due diligence reporting, and a new regulation imposing due diligence reporting as a legal duty of care), with the aim to encourage the inclusion of adverse corporate impacts on human rights and the environment, are contemplated.

Looking at the impact of such policies, the study remarks that the requirement of due diligence reporting as a legal duty of care would be the most effective one as a company should demonstrate that it has met this standard by carrying out the required level of due diligence across the supply chain. This regulatory initiative is likely to give rise to positive effects in terms of human rights and environmental practices (depending on effective monitoring and enforcement), but it would explicitly require burdensome due diligence practices, and the social impact is expected to be quite significant. Business respondents believe that voluntary guidelines could be more effective than imposing specific reporting requirements, in producing a positive impact without leading to negative social impacts.

Source: European Commission, "Study on Due Diligence Requirements Through the Supply Chain", 2020, https://op.europa.eu/en/publication-detail/-/publication/8ba0a8fd-4c83-11ea-b8b7-01aa75ed71a1/language-en.

Our roundtable experts stressed that legislation should be proportionate, with only large companies that may be initially required to disclose information, and subsequently including also small companies in the regulatory scope. In particular for large firms, it is necessary that suppliers put in place adequate infrastructures over time to store and provide decent information to their customers.

Due diligence across supply chain is also challenging because of the many layers. It would be complicated to get material data from the "suppliers of a supplier." This may be more practical in some sectors than others. For example, firms operating in the clothing industry could gather more easily information on the origins of every single component. A practitioner from the south-central European group suggested that regulation could be stricter for the first layer of supply and be more lenient for the other levels. Another expert from the same workshop underlined that some type of assurance, which would be provided by a third-party auditor, should be put in place to check whether or not there is misrepresentation of the information that is disclosed by the company.

Highlight 4: A Stakeholder's View

European corporates have made supply chains' due diligence a priority. They have voluntarily taken steps to ensure a better control of risks linked to human rights and sustainability along their supply chains and they are fully committed to improve the situation.

It would be impossible, however, for large multinational companies to report all of their due diligence processes around the world concerning hundreds of thousands of suppliers or subcontractors, country by country, project by project, or activity by activity. Another challenge would be the time to implement the process and education of the teams.

Due diligence shall contain some limitations as to companies' business relationships and in terms of the scope to exclude small and midsize enterprises. Any development shall be a phased approach, starting with human rights but leaving aside social and environmental aspects at first, as we believe those are already addressed.

The EU should adopt a principle-based approach on due diligence, introducing a process-based requirement. The reporting requirements should be focused on the typology of salient risks identified across undertakings' activities, which would allow interested parties and stakeholders to understand the undertaking's due diligence strategy.

Source: Interview from EuropeanIssuers.

4.3 Issues on Misalignment Between Regulations

Key statement: "Practitioners are concerned about the contrasting language between the current NFRD and the other pieces of legislations."

As briefly explained in Section 3, various pieces of legislation on ESG investments have been adopted in recent years. In this section, we look at the interplay among the rules under the NFRD, the SFDR, and the Taxonomy Regulations.

Practitioners are concerned about the contrasting language between the current NFRD and the other pieces of legislations. Lack of consistency exists as the NFRD requires large undertakings to produce a nonfinancial statement, including information on environmental matters, whereas the Taxonomy Regulations refers only to "environmental sustainability," which has a narrower meaning. This recently has been underlined by the European Insurance and Occupational Pensions Authority (EIOPA) as well.[22]

Furthermore, as opposed to the SFDR, which captures social and employee, respect for human rights, anticorruption, and antibribery matters as well as climate and environment, the Taxonomy Regulation only takes into account environmentally sustainable activities (table 1 provided more details on the aspects to be disclosed under the SFDR). A participant from the south-central European group also stressed that the Taxonomy Regulation "horizontally cuts through" businesses' corporate reporting, as firms are demanded to disclose the proportion of investments in environmentally sustainable economic activities. Hence, this approach is not modeled after the disclosure requirements under the SFDR and the NFRD.

In the context of the NFRD revision, regulators need to reinforce the definition of materiality. This should clearly define sustainability risks and refer to specific rules and guidance (e.g., the SASB standards) when it differentiates between financial and impact materiality, namely double materiality.[23]

[22] See the EIOPA response to the European Commission, "Public Consultation on the Revision of the Non-Financial Reporting Directive," 10 June 2020,: https://www.eiopa.europa.eu/sites/default/files/publications/consultations/eiopa_contribution_com_consultation_on_revision_of_non-financial_reporting_directive.pdf.
[23] The ESAs draft regulation also includes additional and more specific indicators related to climate, environmental aspects, social and employee, respect for human rights, anticorruption, and antibribery matters.

TABLE 1: DISCLOSURE OF PRINCIPAL ADVERSE IMPACT INDICATORS UNDER THE SFDR

	CLIMATE AND OTHER ENVIRONMENT-RELATED INDICATORS
Greenhouse gas emissions	1. Carbon emissions 2. Carbon footprint 3. Weighted average carbon intensity 4. Solid fossil fuel sector exposure
Energy performance	5. Total energy consumption from nonrenewable sources and share of nonrenewable energy consumption 6. Breakdown of energy consumption by type of nonrenewable sources of energy 7. Energy consumption intensity 8. Energy consumption intensity per sector
Biodiversity	9. Biodiversity and ecosystem preservation practices 10. Natural species and protected areas 11. Deforestation
Water	12. Water emissions 13. Exposure to areas of high water stress 14. Untreated discharged waste water
Waste	15. Hazardous waste ratio 16. Nonrecycled waste ratio
	SOCIAL AND EMPLOYEE, RESPECT FOR HUMAN RIGHTS, ANTICORRUPTION, AND ANTIBRIBERY MATTERS
Social and employee matters	17. Implementation of fundamental International Labour Organization Conventions 18. Gender pay gap 19. Excessive CEO pay ratio 20. Board gender diversity 21. Insufficient whistleblower protection 22. Investment in investee companies without workplace accident prevention policies
Human rights	23. Human rights policy 24. Due diligence 25. Processes and measures for preventing trafficking in human beings 26. Operations and suppliers at significant risk of incidents of child labor 27. Operations and suppliers at significant risk of incidents of forced or compulsory labor 28. Number and nature of identified cases of severe human rights issues and incidents 29. Exposure to controversial weapons (land mines and cluster bombs)

Anticorruption and antibribery matters	30. Anticorruption and antibribery policies 31. Cases of insufficient action taken to address breaches of standards of anticorruption and antibribery 32. Number of convictions and amount of fines for violation of anticorruption and antibribery laws

Source: ESAs draft regulatory technical standards on sustainability-related disclosures in the financial services sector with regard to the content, methodologies, and presentation of information in relation to sustainability indicators and the promotion of environmental or social characteristics and sustainable investment objectives in precontractual documents, websites, and periodic reports; CFA Institute adaptation of template on Principal Adverse Impacts Statement, 2020, https://eba.europa.eu/sites/default/documents/files/document_library/Publications/Consultations/2020/Joint%20Consultation%20Paper%20on%20%20ESG%20disclosures%2023042020/883275/jc_2020_16_-_esg_disclosures_cp_-_annex_1.docx.

4.4 ESG Requirements and Their Impact on the Access to Public Markets

Key statement: "Rules should not be different whether a firm is listed or not. Companies with limited resource capacity should reconsider whether it is the right time for them to access public markets."

Looking at the massive amount of information that the SFDR requires businesses to publish, and the direction toward greater disclosure of nonfinancial information in which the EU is going, we asked whether smaller firms would see that as an obstacle when they intend to list on public markets.

Minimum standards of disclosure represent a peculiarity of public markets, which investors can trust. Publication of ESG information increasingly is seen as a core business value for organizations to report, and therefore is not considered a burden, particularly given an observed rise in investor interest in such information. We cannot deny, however, that greater disclosure requirements give rise to higher costs that firms would have to bear. Businesses also would need to recruit staff with specific expertise in the field. Practitioners remarked that rules should not be different whether a firm is listed or not. Companies with limited resource capacity should reconsider whether it is the right time for them to access public markets.

CFA Institute argues that the EU should proceed with its strategy to ensure more available nonfinancial information for all stakeholders. Workshop participants broadly agreed, however, that a distinction on the amount of data to be disclosed should be made between large and small organizations, thus demanding some degree of proportionality to be applied. Large firms, including those that are not listed, already have a corporate social responsibility policy in place driven largely by investor demand. Companies ought to be subject to more proportionate nonfinancial reporting requirements, regardless of whether they are public or private. More proportionality can be ensured if the disclosure of such information would be applied voluntarily in an initial phase, and made mandatory later, for smaller businesses.

5. Corporate Governance Practices in the EU

5.1 Stocktaking of the Comply-or-Explain Approach in the EU

Key statement: "The comply-or-explain mechanism seems to have incentivized more shareholder activism in the field of corporate governance as well as social and environmental matters."

An important discussion that workshop practitioners focused on was the effectiveness of the comply-or-explain mechanism in the EU. This system was first adopted at the supranational level in 2006 with the EU Company Law Directive on statutory audit of annual accounts and consolidated accounts. The revised SRD extends this approach to engagement policies by institutional investors and asset managers. They are asked to either develop a report on an engagement policy describing the details of shareholder integration in their investment strategy or to provide a clear and reasoned explanation as to why they have decided not to do so. The same mechanism also applies for the annual description that institutional investors and asset managers must disclose on voting behavior, including an explanation of the most important votes and how proxy advisers' services have been used.

Practitioners overwhelmingly support the comply-or-explain principle and how this has been applied for particular corporate governance disclosures in the EU. This approach is seen as an opportunity for market participants to create a level playing field rather than letting regulators impose hard rules. The comply-or-explain mechanism seems to have incentivized more shareholder activism in the field of corporate governance as well as social and environmental matters. For instance, for any deviation from the corporate governance code in the Netherlands, investors are allowed to directly contact their company and ask for an explanation. Direct shareholder involvement should contribute to a higher rate of compliance with national corporate governance codes.

The comply-or-explain mechanism is also appreciated because of the greater flexibility that it gives to market participants. Workshop participants emphasized that the implementation of this mechanism would be useful when rules are drastically changed in the field of corporate governance and ESG disclosure. The approach also could be used by regulators as an intermediary step in a way that would give them the opportunity to test the impact of a new legislation. Policymakers could then suggest a series of good standards based on how rules have been followed. Clearly, the objective of the approach is to gradually encourage and incentivize more investment firms into integrating ESG principles as part of their investment and risk management processes.

The discussion also revolved around the quality of explanation in case of deviation from the rules. Practitioners observed that, overall, the industry tends more toward compliance as this is much easier than justifying a deviation from the rules. However, the comply-or-explain system allows firms to resort to just an explanation when compliance would be the right course of action in particular circumstances. The explanation needs to be good and detailed enough to clearly hold the company accountable for noncompliance and to improve the level of engagement between management and shareholders, who ultimately would like to see better governance practices in the company. The EU could adopt a new corporate governance standard, or use existing principles, such as those delivered by the International Organization of Securities Commissions (IOSCO) or the OECD, to clarify how a qualitative explanation should look like.

5.2 Protection of Minority Shareholders' Rights

Key statement: "Inadequate board accountability and representation of minority shareholders are still a big issue in European companies."

The main issue that workshop participants highlighted concerned the protection of minority shareholders' rights. CFA Institute "Corporate Governance Policy in the EU" report remarked that these have been problematic, even after the adoption of SRD II. During the SRD II legislative process, the European Commission intended to fix the loopholes in corporate governance practices in the EU. Because of pushback from member states, however, minority shareholder issues were not appropriately addressed.

SRD II introduced the right for shareholders to express their views on any change to the remuneration policy and to have the right to vote in the general meeting. Companies must submit the policy for shareholder approval at every material change and, in any case, at least every four years. Workshop practitioners emphasized, however, that this was insufficient to ensure that minority shareholders have a say on the remuneration policy of their company. They stressed that the remuneration policy, and other important decisions presented during general meetings, should be subject to a qualified majority voting from shareholders.

Highlight 5: JDE Peet's Corporate Governance Framework

JDE Peet's corporate governance structure represents a case in point of the lack of influence from minority shareholders in company's decisions. The firm, which recently was listed on Euronext Amsterdam, is owned primarily by two other businesses (i.e., JAB Holding Company S.à r.l, and Mondelēz, Inc.), which together have about 60% of the company shares. JDE Peet's board is composed of 9 nonexecutive directors (NEDs) out of 13 members overall, yet these NEDs are affiliated with the two main shareholders of the firm. This casts some doubt on the actual independent nature of the company's board of directors.

The controlling shareholders are able to keep control of the remuneration policy, even though the Dutch law (under the implementation of SRD II) requires that remuneration policies must be adopted with a three-fourth majority of votes. This was possible because firms can derogate from the qualified majority rule when it is otherwise provided by the articles of the association.

The JDE Peet's example shows that insufficient protection of minority owners persists in European companies with controlling shareholders. The risk is that the current situation could negatively affect investor trust in capital markets and the effectiveness of corporate governance codes.

Practitioners agree that a higher voting requirement, such as 75% of cast votes, for the approval of the most important decisions and resolutions in general meetings could ensure more shareholder protection. An alternative solution would be to have a double vote on important resolutions, which would need to be adopted by the majority of minority shareholders.[24] The downside of this approach, however, is that this could lead to a standstill situation if a resolution is approved by the majority of shareholders and voted down by the majority of minority shareholders.

Inadequate board accountability and representation of minority shareholders continue to be significant issues in European companies. Workshop participants stressed that this category of shareholders should be represented in company boards by independent members. This was a practice that also BlackRock recommended for any organization with

[24] This could be similar to what is required for UK firms to approve special resolutions: minority shareholders owning 25% of shares plus one can (1) block any special resolution regarding amendments to the articles of the association, (2) offer to issue shares in the company to existing shareholders other than on a pro-rata basis by disapplying preemption rights, (3) reduce share capital, and (4) redeem or repurchase shares out of capital.

controlling owners, in its recent corporate governance and proxy advisers' guidelines for the Europe, Middle East, and Africa region. In particular, when looking at Italian companies' board structure, BlackRock suggested that in controlled companies, independent directors should make up of least one-third of the entire board.[25] Boards with a reasonable number of nonexecutive directors are more likely to represent the long-term interests of minority shareholders.

5.3 Differential Ownership Rights and Consequences for Minority Shareholders

Key statement: "Deviations from the one-share, one-vote principle excessively benefit controlling shareholders compared with minority owners, who experience insufficient protection."

The differential ownership rights mechanism is a consolidated practice in many EU member states. By introducing different control rights, multiple class shares give rise to several benefits to controlling shareholders, which can easily maintain a stable grip on the organization. Dual-class shares allow majority owners to effectively keep control of the company with a relatively lower number of shares.

In Europe, multiple class shares (loyalty shares) typically are issued with the rationale of attracting long-term investments in the corporation as they grant long-term shareholders with additional voting rights. This practice is widespread in France and Italy. In France, the *Loi Florange*, which was adopted in 2014, set out a series of measures supporting the economy and encouraging long-term shareholding. Investors holding nominative shares for more than two years are entitled, under the law, to double voting rights. In Italy, the 2014 Competitivity decree allows listed companies to issue loyalty shares granting up to two votes per shares to shareholders holding shares for at least 24 months. Before going public, Italian private companies also can issue multiple voting shares, which can give up to three voting rights per share.

Practitioners agreed that deviations from the one-share, one-vote principle excessively benefit controlling shareholders compared with minority owners, who experience insufficient protection. A participant stressed that shares with multiple voting rights permit

[25] BlackRock Investment Stewardship, "Proxy Voting Guidelines for European, Middle Eastern, and African Securities," January 2021, https://www.blackrock.com/corporate/literature/fact-sheet/blk-responsible-investment-guidelines-emea.pdf.

large shareholders to extract private gains at the expense of the company and of the other shareholders. Another practitioner pointed out that, in certain situations, issuing dual-class shares could be valuable for the well-being of a business. An example is the company's increased and more effective capacity of resisting to an activist's takeover that could result in an ill-advised replacement of management. Disproportionate voting rights, however, also could allow the incumbents to protect their position and to fend off an attempted takeover that would reshape management and put in place better governance practices.

Some practitioners highlighted the unintended impact of diverse legislative regime-sacross the EU on the matter. The Dutch regime,[26] which allows companies to issue a vast category of shares, like shares with multiple voting rights, or limited voting rights, has attracted many corporations to do business in the Netherlands and move their legal headquarters in the country.

Highlight 6: How Italian Companies Became Dutch

Fiat Chrysler Automobiles N.V. (FCA) is an Italian–American organization that moved its corporate headquarters to Amsterdam in 2014. FCA's largest owner is Exor N.V. holding 28.66% of the shares. As a result of the loyalty voting mechanism that FCA has applied, however, Exor N.V. owns 41.74% of the firm's voting rights. Similar examples of Italian-based corporations moving their corporate headquarters to the Netherlands have occurred in the past decade, such as Ferrari (owned by the same holding group as FCA) and Campari. The latter firm moved its registered office in early 2020, to take advantage of the flexible governance practices that are allowed under the Dutch company law. Campari's 2019 annual report indicates the move as an opportunity "to encourage a capital structure more supportive of the Group's long-term external growth strategies, and reward a shareholder base with a long-term investment horizon."

Sources: Fiat Chrysler Automobiles, 2019 Annual Report and Form 20-F for the year ended 31 December 2019, "Shareholders' Rights in Private and Public Companies in The Netherlands: Overview, https://www.fcagroup.com/en-US/investors/financial_regulatory/financial_reports/files/FCA_NV_2019_Annual_Report.pdf; Davide Campari-Milano S.p.A. Annual Report at 31 December 2019, https://www.camparigroup.com/sites/default/files/downloads/01.2_annual_report_2019.pdf.

[26] For major details on the rules on voting rights under the Dutch Civil Code, please see Michiel Pannekoek, Houthoff, "Shareholders' Rights in Private and Public Companies in The Netherlands: Overview," Thomas Reuters, 1 January 2018, https://content.next.westlaw.com/Document/Iee9dae370b9911e598db8b09b4f043e0/View/FullText.html?contextData=(sc.Default)&transitionType=Default&firstPage=true&bhcp=1.

In light of the diaspora of some of the most iconic Italian organizations, , the Italian executive intended to amend the 2014 law and enhance flexibility for listed companies to issue multiple voting rights by up to three voting rights per share. At the eleventh hour, however, the measure, which was included in the draft text of the "Recovery" decree 2020, was removed in the final legislation.[27]

Several practitioners advocated that the European Commission should regulate the practice of differential ownership rights. The EU may attempt to impose a harmonized maximum number of voting rights, which European companies could grant per each share.

Finally, a participant raised the need for greater disclosure on the adoption of differential ownership rights as, most of the time, investors can be abreast of that only by reading directly company websites. This type of practice also should be communicated in market pages to ensure that potential investors purchasing shares are aware that their voting rights may be diluted in the future.

5.4 Will Covid-19 Affect Businesses' Approach Toward Employees?

Key statement: "Better support of employees and the surrounding community is seen as a precondition for firms to provide the best risk-adjusted results in the long term for their shareholders."

Workshop participants also were asked whether the Covid-19 crisis would have an impact on businesses' ultimate goal of maximizing their shareholder wealth. The discussion underscored that this model is now being challenged, especially from the perspective of young generations. Additionally, the importance of focusing only on shareholder value was questioned well before the outbreak of the coronavirus crisis.

Moreover, practitioners argued that the objectives of maximizing shareholder wealth in the long run and taking stakeholder interest into consideration do not need to be mutually exclusive. The argument should be that focusing on the interest and considerations of all stakeholders should align with the interest of shareholders over the long term. The logic would be to align everyone's objectives toward longer-term goals.

[27] Andrea Pira and Milano Finanza, "Dl Rilancio, nell'ultima bozza salta il voto plurimo per le quotate," 19 May 2020, https://www.milanofinanza.it/news/dl-rilancio-nell-ultima-bozza-salta-il-voto-plurimo-per-le-quotate-202005191315575222

Covid-19 seemed to have accelerated a trend that was already established: businesses increasingly are looking to deliver value to stakeholders and, in particular, to their employees. Better support of employees and the surrounding community is seen as a precondition for firms to provide the best risk-adjusted results in the long term for their shareholders. Dealing with employees and social matters is fundamental to draw investors into financing organizations.

The "Corporate Governance Policy in the EU" report stressed that it is possible to reconcile shareholder, stakeholders (including companies' workers), and open-market perspectives without diluting investors' rights and interests. An approach toward stakeholder value, which would involve a longer-term horizon in corporate decisions and business strategies, can be adopted while ensuring shareholder wealth creation. As described in Section 3, the European Commission intends to encourage a more sustainable corporate governance in the EU and is likely to put forward a legislative proposal in the first quarter of 2021.

The concept of maximization of shareholder value is difficult to find in today's corporate governance codes. For instance, long-term value creation is a fundamental principle of the latest version of the Dutch corporate governance code.[28] The latter highlights that stakeholder interests are relevant and should be considered to create long-term value for the company and, thus, for shareholders. The debate in the Netherlands is now taking a step forward as the local industry is pressing for the inclusion of corporate citizenship in the legal status of companies. Workshop experts believe that this discussion could emerge soon at EU level as well.

Some businesses already have included a social mission in their legal status. This is due to the pressing demand from institutional investors that have been asking for more consideration not only of employee interests but also of society. For example, BlackRock called on companies to serve all stakeholders, noting that in this manner, both companies and society could enjoy greater long-term prosperity.[29] Taking into account the benefit of society as a whole is necessary for organizations to be able to adequately reward shareholders.

The coronavirus crisis has raised the issue of how to keep employees engaged and motivated. Firms have been urged to better support staff throughout this period. In crisis times, however, shareholders and management may exhibit a tendency toward

[28] See Monitoring Commissie, "The Revised Dutch Corporate Governance Code 2016," 8 December 2016, https://www.mccg.nl/?page=4738.

[29] Larry Fink, "A Fundamental Reshaping of Finance" (annual letter on corporate governance), BlackRock, 2020, https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter.

Highlight 7: Danone

Danone, the French multinational food-products corporation, is an example of a firm adding a social mission in its bylaws. "Bringing health through food to as many people as possible" is the new group's mission, which commits management not only to increase shareholder value but also to do so in a way that benefits stakeholders' health. Danone also has established a specific committee, composed of external experts, that would assess the company's achievements in their social, societal, and environmental objectives.

Source: See Danone, Our Mission, https://www.danone.com/about-danone/sustainable-value-creation/our-mission.html; and Leila Bboud, "Danone Adopts New Legal Status to Reflect Social Mission," *Financial Times*, 26 June 2020, https://www.ft.com/content/1eff9241-ef11-4a38-8b5c-bb825fa108ca?accessToken=zwAAAXPnjS3Akc8e_5JB7xFKONOLXLuCX6EIyg.MEQCIH3aCMz-9zrIbN4VkJtWzVUXIOKi9nrMwGTYT87YJV-OAiAn6V4KXLKlzcUq6LDwTEWWnUyTxvblxMO9cCt2FqJPXg&sharetype=gift?token=78be9164-3ba0-4a76-b014-5c12991bec5d.

entrenchment strategies. A practitioner mentioned the case of Air Berlin, which was the second German airline, that filed for bankruptcy in 2017. Air Berlin's financial issues and mistreatment of employees went hand in hand and caused the company's default. Staff claimed that they had been put under significant psychological pressure for many years and that the airline lacked quality management to steer teams through difficult times.[30]

We have observed a relationship between the quality of companies' social relations with their employees and their market performance, which is linked to symptoms such as low job performance and productivity. A workshop participant pointed out, however, that markets should begin to consider these working condition issues from a sectoral standpoint, as different industries follow different levels of practices.

Organizations could involve and motivate their employees in different ways. The implementation of employee shareholding schemes can benefit company staff, who would feel involved in the organization's business. The practice of employees shareholding schemes could be used in light of the Covid-19 crisis. The European Federation of Employee Share Ownership suggested that some or all state funding that was granted to firms under financial trouble could be redirected to employees through an employee share ownership fund,

[30] Jens Koenen, "Air Berlin Staff Reach Breaking Point," Handelsblatt, 7 April 2017, https://www.handelsblatt.com/english/companies/cabin-chaos-air-berlin-staff-reach-breaking-point/23570868.html?ticket=ST-6691180-KPokOqxTH4sartbQOfBJ-ap4.

Highlight 8: A stakeholder view on a pan-EU European Share Ownership Plan

Exogenous and unpredictable events, as the COVID-19 pandemic, confirm that it has become imperative to reinforce the link between long-term value creation and sustainability and align better the long-term interests of management, shareholders, and society. This however requires shifting from the paradigm of a corporate culture that tends to focus on short-term performance at the expenses of long-term objectives, with companies better involving employees in shaping their corporate governance, and boards taking into account individual nonprofessional shareholder's inputs.

BETTER FINANCE firmly believes that a **Pan- EU Employee Share Ownership (ESO) plan** is crucial for the success of the Capital Markets Union (CMU) and facing the Covid-19 crisis. Moreover, a Pan-EU ESO would empower sustainable investments for EU citizens, as equities are the financial instrument most likely to protect the real value of their lifetime financial savings over the long-term. As an important tool of increasing financial literacy at the workplace, ESO also has the potential to widely promote the sustainability issues. There is evidence that companies participating in ESO plans are more resilient in times of crisis and tend towards increased responsibility, holding the environment in higher regard.

A pan-EU ESO has a pivotal and positive role to play in corporate governance matters and BETTER FINANCE advocates it should be part of any push by EU authorities to further embed this project as part of the Sustainable Corporate Governance framework and the Capital Markets Union. In fact, ESO is the necessary tool allowing employees to demand embedding sustainability in corporate matters by focussing on long-term development and environmental responsibility over short-term financial performance.

Source: Interview with BETTER FINANCE

which would help workers acquire their company's shares and, thus, become shareholders.[31] Employees also could be allowed to participate in shaping their firm's governance system. For instance, in Germany, employees are entitled to have a strong say on their company's governance. In addition, the German Corporate Governance Code requires that supervisory boards are composed of both shareholder and employee representatives, depending on the number of workers in companies.

[31] European Federation of Employee Share Ownership, "Employee Share Ownership Against the Crisis," 7 May 2020, http://www.efesonline.org/CORONA/Proposal%20-%20An%20employee%20share%20ownership%20found%20to%20help%20companies.pdf.

Finally, the discussion focused on whether managers owe their fiduciary responsibility to their stakeholders, not just to company shareholders. Practitioners argued that managers should always first of all look at the sustainable health of their firm and, therefore, the financial well-being of the shareholders. Nevertheless, if organizations extend the time horizon over which they try to maximize their returns, shareholder and stakeholder values would tend to converge. A participant from the south-central European group emphasized that it is in the company and shareholders' best interests that managers also owe their fiduciary duty to stakeholders. It is important to clearly identify, however, who is a stakeholder of an organization. This would be a key task for the board of directors.

5.5 SRD II: Should Implementation Have Been Postponed?

Key statement: "A postponement in the application of SRD II would not have been desirable as the directive introduces important improvements for shareholder rights."

The Covid-19 crisis has brought about several calls for a postponement of the implementation of SRD II. Stakeholders claimed that organizations have reprioritized their activities and shifted resources to tackle the unprecedented challenges that the pandemic has raised. This situation has made it difficult for companies and other market participants to adapt in light of the SRD II requirements.[32] Despite understanding the reasons for such a call for a delay in the implementation of the directive, the European Commission confirmed the deadline of 3 September 2020 for member states to transpose SRD II rules into national law.

Our workshop experts agreed that a postponement in the application of SRD II would not have been desirable as the directive introduces important improvements for shareholder rights. For example, one of the issues that the 2016 "Corporate Governance Policy in the EU" report highlighted was the plumbing of cross-border proxy voting as shareholders encountered many challenges regarding their participation in general meetings across borders and voting in an informal manner.

A practitioner also remarked that the steady implementation of SRD II is even more important in this period, given that the deadlines regarding the notice that shareholders

[32] See the letter by a group of European trade associations, "Joint Trade Association Letter on the Impact of COVID-19 on the Further Implementation of the Shareholder Rights Directive II," 9 April 2020, https://www.ebf.eu/wp-content/uploads/2020/04/Joint-Trade-Association-letter-on-SRDII-and-COVID-19_internal.pdf.

should give for their participation in general meetings have been drastically shortened in several member states because of the necessary shift to virtual meetings. For example, in Germany, the management board can give notice to shareholders about a general meeting and send invitations to participate only 21 days before the date of meeting rather than 36 days, as previously was established. In addition, shareholders can register for general meetings only six days before the meeting.[33]

Many stressed that EU firms and, in particular, custodians and intermediaries should be ready for the new rules. They have had enough time to prepare themselves for the rules on cross-border voting, which are seen as an important change under the SRD II. A delay in the implementation of the directive would go against the regulators' intent, which was to facilitate the exercise of shareholders' rights.

[33] For major details, please see the summary by Sullivan & Cromwell LLP, "Germany Introduces Online-Only Shareholders' Meetings in Response to Covid-19," on the new German Act for the mitigation of the consequences of the COVID-19 pandemic, which was adopted on 25 March 2020, https://www.sullcrom.com/files/upload/SC-Publication-Germany-Introduces-Online-Only-Shareholders-Meetings-in-Response-to-COVID-19.pdf.

6. Covid-19 and Its Impact on AGMs

Key statement: "The current technical issues and obstacles to shareholder engagement eventually will be fixed as corporations will be better prepared to hold hybrid AGMs."

Social distancing rules and the prohibition of large gatherings had an enormous impact on companies' AGMs in 2020. EU legislators adopted a proposal for a temporary derogation (until the end of the 2020) to the current rules on general meetings. Organizations were not obliged to hold their AGMs within 6 months of the end of their financial year and were allowed to arrange them within 12 months after the end of their financial year and until 31 December 2020.[34]

The majority of European companies, however, have chosen not to delay their AGMs but rather to hold them in a virtual format. The main reason for switching to online meetings was the apparent impossibility of running regular physical general meetings before the end of 2020 as the pandemic hit hard Europe as well as the rest of the world. Technology could enable decent participation in AGMs at a time when travel restrictions were put in place in most countries around the world.

Emergency regulations setting out specific measures to hold AGMs during the pandemic have been adopted in many EU member states to offer alternatives to physical meetings. For example, the Dutch Emergency Act, which was approved in April 2020, allows the management board to organize a valid virtual meeting, irrespective of whether this possibility is mentioned in companies' bylaws. Alternatively, organizations can convene hybrid general meetings, with shareholders who may decide to take part either in person or virtually, or may postpone the gathering.[35]

Practitioners shared their experience on the virtual meetings held in the first half of 2020. Virtual meetings seemed to have made it easier for shareholders to participate and vote. Companies have been keen on engaging with shareholders (particularly with institutional

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[34] Council Regulation (EU) 2020/699 on temporary measures concerning the general meetings of European companies (SEs) and of European Cooperative Societies (SCEs), 25 May 2020, https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32020R0699&from=EN.

[35] Temporary COVID-19 Justice and Security Act, Tijdelijke voorzieningen op het terrein van het Ministerie van Justitie en Veiligheid in verband met de uitbraak van COVID-19 (Tijdelijke wet COVID-19 Justitie en Veiligheid), April 2020, https://www.rijksoverheid.nl/binaries/rijksoverheid/documenten/kamerstukken/2020/04/08/tijdelijke-wet-covid-19-justitie-en-veiligheid/Tijdelijke+wet+COVID-19+JenV+Wetsvoorstel+versie+TK+08042020+CORR.pdf.

investors) before their AGM takes place. Therefore, investors have the opportunity to discuss all AGM items in detail with the board of directors and management before the meeting.

Shareholders also have been able to submit written questions in advance, and these can be answered by the board and auditors either before the AGM or during the meeting. Because investors are not aware of the details of the discussions and communications that will be given in the AGM, however, they cannot engage with the company efficiently and cannot ask detailed questions beforehand. In addition, some workshop participants stressed that not all companies have given the option for shareholders to ask follow-up questions if a response to a submitted question has not been entirely satisfying. Similarly, directors may deliberately discard questions and avoid responding to topics that they are not totally comfortable addressing. This situation clearly limits the accountability of the board of directors and the company's auditors in relation to their shareholders.

Practitioners agree that hybrid meetings will be the standard format of AGMs in the future. Technology can offer a good solution to facilitate the ability for cross-border shareholders to participate in AGMs and to vote on resolutions. Hybrid meetings would give more flexibility to investors, who may decide to participate in person or join virtually and send questions. This typology of meetings would be more cost-effective for companies, which would save significant expense incurred for the organization to hold large physical gatherings. The current technical issues and obstacles to shareholder engagement eventually will be fixed as corporations will be better prepared to hold hybrid AGMs.

CFA Institute currently is working on a report analyzing the current challenges regarding the conduct of AGMs and shareholder issues in the Asia-Pacific region. The report, which is expected to be published later in 2021, will include practical guidelines for AGMs and engagement as well as policy recommendations for regulators in Asia Pacific.

7. Corporate Governance Practices in the United Kingdom

Key statement: "The world is expected to wait and see whether the new UK Stewardship Code is effective in the UK before adopting a similar set of principles."

Practitioners expect developments in two particular areas of corporate governance in the United Kingdom.

The first area is the corporate purpose, where more disclosure is demanded about the overall framework within which the board of directors govern an organization and what they aim to deliver. Greater transparency on the purpose of a business may be a good opportunity for firms to go beyond a pure shareholder focus and increasingly to look at the delivery of values for all stakeholders of a company.

The second area in which improvements are expected is viability reporting. The Brydon report, which Sir Donald Brydon CBE[36] prepared for the secretary of state at end of 2019, suggested the adoption of a Resilience Statement that would replace the existing Going Concern and Viability Statements. This new Resilience Statement would be composed of (1) a short-term report, including the existing going concern statement, as well as increased disclosure of material uncertainties that could negatively affect the company as a going concern; (2) a more complete version of the Going Concern and Viability report, including stress testing a variety of scenarios that could have an impact on the business model; and (3) a long-term component looking at the company's business strategy and whether it takes into account potential risks and threats, including those from the outside environment (e.g. climate change).[37]

The Brydon report shows that the United Kingdom might move in the direction of encouraging management to have a long-term view of their business in terms of achieving results for all participants in the corporation and looking at long-term risks that could threaten the survival and prosperity of a business in the future. For instance, companies

[36] Abbreviation standing for Commander of the Order of the British Empire.
[37] Sir Donald Brydon CBE, "Assess, Assure and Inform — Improving Audit Quality and Effectiveness," Report of the Independent Review into the Quality and Effectiveness of Audit, December 2019, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/852960/brydon-review-final-report.pdf.

looking at a 10-year time horizon when setting up their strategy might eventually attract more long-term investors.

The 2020 Stewardship code represents a massive step forward as it sets out many demanding standards for asset owners, investment managers, and service providers. In addition, the code contains more detailed expectations for listed equity assets.

Asset owners and managers are required to report on their stewardship activities and outcomes, covering a period of 12 months. The code establishes a set of comply-or-explain principles for these individuals and another six principles for the service providers that support them.[38]

Concerning listed equity assets, signatories are expected to provide disclosure on their voting policy, the extent to which they use default recommendations from proxy advisers, and the extent to which clients may override a house policy. They also are required to disclose their policy on allowing clients to direct voting in segregated and pooled accounts and to indicate what approach they have taken to stock lending.

The code aims to stimulate deeper engagement with shareholders, and especially institutional investors, and to improve the level of reporting for listed companies. This also includes higher expectations for clear disclosure on ESG practices.

UK practitioners believe that other countries, including the EU, will not soon replicate this new Stewardship Code as a corporate governance model. Since the 2020 update introduced drastic changes, the world is expected to wait and see whether the code is effective in the United Kingdom before adopting a similar set of principles. A workshop participant argued that the EU eventually will follow the United Kingdom in terms of the direction that the Stewardship Code is moving. The EU may follow this code, however, through their own mechanism as the European corporate governance model is based on a rule-based approach, whereas the stewardship code is built around the comply-or-explain principle.

We also asked whether the corporate governance of large private companies should be regulated as well. The United Kingdom adopted a new legislation in this area in 2018. "The Companies (Miscellaneous Reporting) Regulations"[39] require all companies of

[38] Service providers that support asset owners and managers typically include those that carry out the following activities: engagement, voting recommendations and execution, data and research provision, advice, and provision of reporting frameworks and standards.
[39] For more details, please see the legislative text of "The Companies (Miscellaneous Reporting) Regulations 2018," https://www.legislation.gov.uk/uksi/2018/860/contents/made.

a significant size to provide a corporate governance statement indicating the corporate governance code that is applied, and how it is enforced. If companies do not apply any corporate governance code, they must explain the reasons for not doing so.

The UK government appointed James Wates CBE to chair an industry group to look at the matter and a report was published in 2018. The Wates report offers six guiding principles for large private companies that are required to comply with new corporate governance requirements under the Companies Regulations. The report is based on the apply-and-explain' principle, which entails organizations to apply the guidance principles and explain how they have adopted them in their governance practices.[40]

Practitioners emphasized that this is the first report that focuses on the largest companies' governance practices. It is, therefore, too early to tell whether this guidance will be broadly followed. The expectation is that corporate governance will be regulated in a flexible manner, with different levels of regulation and oversight that could fall. Such a model might not be appropriate for the EU as European regulators typically focus on a harder and faster approach. Given the more structured regulatory approach on corporate governance, however, we feel that an effective regulated regime for private companies' governance practices could be more feasible in the EU.

[40] To find out more about the principles proposed in the Wates report, see Financial Reporting Council, "The Wates Corporate Governance Principles for Large Private Companies," December 2018, https://www.frc.org.uk/getattachment/31dfb844-6d4b-4093-9bfe-19cee2c29cda/Wates-Corporate-Governance-Principles-for-LPC-Dec-2018.pdf.

8. Action Memoranda

Similar to CFA Institute 2016 "Corporate Governance Policy in the EU" report, we have included three action memoranda, which contain recommendation on initiatives and key steps for three categories of stakeholders (policymakers, investors, and companies) that are involved in shaping better European corporate governance and ESG disclosure practices. We reiterate that regulation is not enough to steer good corporate governance and that greater engagement from all interested parties is necessary as well.

8.1 Memo to Policymakers

To: European Commission, European Parliament, and national regulators

From: CFA Institute

Subject: Your role in the improvement of corporate governance in the EU

Issues:

- Accountability and protection of minority shareholders is still lacking;
- Differential ownership rights practices weaken the exercise of small shareholder rights while allowing controlling investors to retain control over a company; and
- The current EU legislations on disclosure of ESG information (SFDR, NFRD, and the Taxonomy Regulation) feature some overlapping issues and inconsistencies that may lead to confusion for end investors. The absence of reliable and consistent data is a significant drag to their adoption and enforcement.

The adoption of SRD II was an important step toward addressing some of the key issues that we highlighted in our 2016 report. This directive is expected to encourage better engagement practices from firms and ensure improved shareholder protection. This is why we welcome the European Commission's decision to go ahead with the final implementation of the SRD II, with member states that were required to transpose the directive into national law by 3 September 2020. A delay in the second phase of implementation of the legislation (the first phase imposing the transposition of limited requirements under the SRD took place on 10 June 2019), which was recommended by several European trade organizations, would not have gone in the direction of fixing important investor protection issues in the EU.

Protection of minority shareholders' rights is still insufficient. Small shareholders do not have the opportunity to have a relevant say on important matters that are subject to voting in AGMs. Moreover, we feel that minority shareholders' interests often are neglected as they are seldom represented in European board companies.

Differential ownership rights are unfortunately a common practice in several member states and is regulated in different ways across countries. While we think that the best approach would be not to permit the issuance of multiple class shares, we understand that these measures normally are regulated at the local level in the context of national company laws. Nevertheless, we believe that EU policymakers could, at least, attempt to limit the abuse of these measures by imposing a cap on the number of voting rights that could be allocated per share. Some harmonization of national frameworks would stop the misuse of these practices hurting minority owners' rights with the purpose of facilitating majority shareholders' control on companies.

National regulators play a key role in the build-up of optimal corporate governance standards in the EU. They should ensure a timely and smooth implementation of SRD II and do not promote measures that could weaken the exercise of minority shareholder rights.

Greater dialogue between EU and national regulators, and European organizations is needed to raise the current governance standards for the well-being of investors and investee companies.

The EU initiatives on ESG disclosures are laudable and would provide greater transparency on the sustainable impact of companies' investment decisions. Investors and stakeholders are increasingly seeking this information. The current inconsistency regarding the scope and the language of the recent regulations on sustainable finance, however, may confuse investors who could misinterpret the vast array of ESG information at their disposal. Another challenge is that these disclosure requirements will become applicable relatively soon at a time when ESG data are rarely available. It therefore is problematic for entities and the scoped market players to publish this information. We call on European legislators to look at the issue to ensure more clarity and better investors' understanding. In the same vein, the revision of the NFRD should focus on the improvement of the materiality concept. In particular, double materiality should be better defined to ensure that impact materiality is correctly and consistently applied.

8.2 Memo to European Companies

To: European companies

From: CFA Institute

Subject: Your role in the improvement of corporate governance in the EU

Issues:

- The interest of all company's actors and stakeholders are not always aligned, and short-term views are often prioritized without taking into account the interests and concerns of the wider spectrum of stakeholders, for the benefit of society as a whole;
- Engagement between companies and shareholders is still poor; and
- The shift to virtual AGMs has made it more difficult for minority shareholders to actively exercise their rights.

European companies are increasingly developing long-term strategies that aim to deliver value not only to its shareholders, but also to the interested parties, including its employees. With the pandemic, many organizations started looking at stakeholder's interests and needs.

We encourage more companies to better align companies' and their investors' interests with those of employees and society, taking into account the impact of investment decisions as well as their risks and opportunities. Organizations should understand that value creation that considers all stakeholders does not need to be accomplished to the detriment of the company's financial objectives and that of its shareholders. The ability to integrate society's needs in the business strategy and the adoption of a long-term approach are actually some of the characteristics that potential investors look for when investing in a company.

Additionally, firms should have greater engagement practices with investors. As this was an issue that we stressed in in our 2016 corporate governance policy report, we believe that a more constructive dialogue between company and shareholders should be developed. In the context of the comply-or-explain approach, we urge organizations to provide a clear and credible explanation when they choose noncompliance. A better explanation of why management goes in a different direction in its governance practices than what it is recommended in comply-or-explain codes can improve accountability and enhance engagement with shareholders.

The organization of virtual AGMs brought about benefits and disadvantages for shareholders. The possibility to participate more easily in an AGM through video conferencing platforms could be offered in the future even when gathering and travel restrictions will no longer be in place. We underscore, however, that companies should address practical issues that have impeded or weakened minority shareholders' active participation in AGMs before deciding to shift permanently to hybrid meetings.

8.3 Memo to European Investors

To: European institutional investors

From: CFA Institute

Subject: Your role in the improvement of corporate governance in the EU

Issues:

- Shareholders often choose not to exercise their rights, and do not engage actively to shape the corporate governance of their organization; and
- An understanding is lacking that pursuing long-term interests of all stakeholders does not need to weaken investor rights or negatively affect shareholders' equity value.

Investors should be more involved in the process of development of better corporate governance practices. They are called on to increasingly engage with asset managers to influence their company's ESG choices. They should press for their rights to be recognized, and then properly exercise them. In many cases, shareholders have been given their rights and powers, but they fail to either exercise them, or completely take advantage of their potential. This lack of engagement affects how investors are seen by management and the way in which these investors will determine their investment decisions. Regulators also have a role to play in this equation. Should they evaluate that shareholders are in general uninterested in engaging with company directors, they could see little justification in exercising supervision and control over the company practices as regards shareholders' rights and interests.

The "comply-or-explain" mechanism appears to have made it easier for shareholders to actively have a say on management's decisions. The adoption of this system has led to more accountability from asset managers for the companies that they invest in. Only through their engagement, however, can shareholders push executives to comply with corporate governance rules or provide a clear and valid explanation as to why they have gone in a different direction. Over time, this new level of shareholder engagement may lead to a better balance between the interests of shareholders (value creation in exchange for financial risk) and the long-term considerations of the wider pool of stakeholders (the interests of society at large). Ultimately, the objective would be to demonstrate that company policies and procedures that would consider a wider social mission in their design are not intrinsically antinomic to shareholders' interests.

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