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To the European Commission

Call for a Redirection of EU Sustainable Corporate Governance Reform Proposals

We call on the European Commission to redirect its far-reaching proposals for sustainable corporate governance. Game-changing proposals should be based on careful research in accordance with scientific evidence. This is currently not the case. We urge the Commission to reflect on the substantial concerns raised by the European business community and by leading scholars . The Commission's hasty policymaking on sustainable corporate governance is underpinned by erroneous and biased assumptions that are likely to have unintended and undesirable consequences.

Our concerns

- The notion of European businesess as short-termist and opposed to sustainability is wrong. On the contrary, in international comparison, European corporate governance is characterized by long-term owners and strong stakeholder protection, for example through employee representation. Moreover, European businesses are eager to take the lead in sustainability and a new green deal.

- Share buybacks, dividends, incentive systems and earnings announcement are not indicators of short-termism, but indicators of a well-functioning modern stock market. When companies have more cash than they can profitably invest, the excess should be paid out to avoid mismanagement and agency problems. Shareholders reinvest the funds in beneficial projects elsewhere.

- Uninformed experiments with sustainability commissioners on company boards, stakeholder councils, political directors' duties and weakened accountability to shareholders risk seriously weakening European corporate governance and the agility of European businesses.

- The proposed reforms will prevent European businesses from taking the global lead in sustainability because they will be bogged down by red tape, risk aversion and governance conflicts.

- Rash, radical regulation risks alienating the European business community as well as the academic community thus fostering discord in European Union rather than a common striving for a sustainable society.

Background

The European Commission is currently considering EU legislation on ”sustainable corporate governance”. The legislation is based on a study by Ernst & Young (EY) Italy on ”Directors' Duties and Sustainable Corporate Governance” which the Commission commissioned and published in 2020. The Commission has concluded that “*the Study found a clear trend of short-termism in the focus of EU companies. It identified key drivers of this issue, ranging from the narrow interpretation of directors duties and the company's interest with the tendency to favour the short-term maximisation of financial value, through growing pressure from investors and the lack of a strategic perspective on sustainability all the way to the limited enforcement of the directors' duty to act in the long-term interest of company. In order to lengthen the time horizon in corporate decision-making and to promote a corporate governance that is more conducive to* *sustainability, the Study also identified specific objectives that EU intervention could aim to reach".*

However, the "evidence" published in the EY report is erroneous and biased. The ensuing consultation process led to scathing criticism from academics and business organisations. A 3-day hearing on the report by the European Corporate Governance Institute (ECGI) – the highest academic authority on corporate governance in Europe - concluded that the report should be *"disregarded"* altogether. There was *"…unanimous agreement that corporate governance is central to sustainability, but that most of the actions proposed in the EY Report are not those that are needed to deliver on the sustainable growth objectives. Worse, if implemented, they could do harm."*

Nevertheless, the EU Commission's Inception Impact Assessment and the highly biased consultation of the 26 October 2020 demonstrate that the Commission has taken the study's findings at face value. A "call for reflection" signed by ECGI members around the world – from Oxford, Harvard, Insead and other leading universities – therefore recommended that the *"Commission carefully consider the substantial concerns raised through the consultation"* since *"well-intentioned but ill-considered prescriptive corporate governance reform can make it harder, not easier, to address the pressing social challenges."*

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