VIRTUAL MEETING WITH THE CEO'S OF BENELUX BUSINESS FEDERATIONS ON DUE DILIGENCE

12 JANUARY 2021, 11:00

Scene setter

- The virtual meeting takes place at the request of the business federations of BE, NL and LU.
- Most recent developments in the field of sustainable corporate governance include support from both EU co-legislators for EU legislation on corporate governance reform.
- **Employment and Social Affairs Council:** on **1 December 2020,** the Council unanimously adopted its **conclusions on "Human Rights and Decent Work in Global Supply Chains",** calling on the Commission to table a **proposal** for an EU legal framework on **sustainable corporate governance, including** cross-sector corporate **due diligence** obligations along global supply chains, which "could include a definition of what kind of risk management process companies need to follow to identify, prevent, mitigate and account for its adverse human and labour rights and environmental impacts".
- **European Parliament**: on **17 December 2020**, the EP adopted its own initiative report (non-legislative) on **"Sustainable Corporate Governance"** (rapporteur Pascal Durand, Renew, FR, adopted by 347 vs 300 votes, with 47 abstentions), calling on the Commission to present a **legislative proposal** on the **redefinition of directors' duty of care**.

On the same day, the shadow rapporteurs reached a **political agreement on the EP's** own initiative legislative report (INL) on **"Corporate Due Diligence and Corporate Accountability"** (rapporteur Lara Wolters, S&D, NL). S&D, EPP, Renew, Greens and GUE are on board. The vote in the JURI committee is expected to be set for 27 January, the plenary vote is scheduled for early March. Both reports reduce the scope of application to large companies and listed and high risk SMEs. In the Wolters report, civil liability would be included but to the extent that the company brought to court contributed to the damage caused (without expressly putting it in a "first tier" approach).

- **NL** adopted a Child Labour Due Diligence Law in 2019. With regard to a **broader due diligence legislation**, the government decided last year to support common EU level rules.
- **All business associations** which submitted **feedback to the Commission's Inception Impact Assessment** (including some EU level associations, but no specific federations from the Benelux) **support** the Commission's underlying objectives and some of them generally agree on the need to act in the sphere of **due diligence**. SE, FI and DK business associations are critical about (at least some parts of) new directors duties while some others (European Issuers, IT, FR asset managers) are -at least partly- supportive of these board duties and new rules on remuneration.

- La FEB va répondre à la consultation publique (qui se clôture le 8 février). Comme vous le savez, la FEB est en faveur d'une approche sectorielle et de préférence volontaire. Ils sont notamment préoccupés par le volet responsabilité civile au-delà du premier rang (« first tier ») de la chaîne de valeur. On peut s'attendre à un intérêt [redacted] sur le volet corporate governance (notamment en cas de sanctions ou de modulation de la rémunération des administrateurs).
- La réunion se tiendra en anglais.
- **Participants** from the 3 business associations:
    - BE: FEB/VBO [redacted]
    - NL: VNO/NCW [redacted]
    - LUX: FEDIL [redacted]

(the Permanent Delegates to BusinessEurope of the 3 organisations will attend the call in a passive way)

- **Scenario**: Chairman of the meeting: FEDIL [redacted]

NB: les participants souhaiteraient pouvoir successivement présenter leur position, avant que vous y réagissiez (11h50).

- 11h00 Brief introduction of the Commission and the delegation of the 3 Benelux employer's' federations + purpose of the meeting (5 min')
- 11h05 Brief introduction of the future Commission initiative by Commissioner D. Reynders (10 min')
- 11h15 Interventions by the 3 federations/presentation of main messages (35 min)
- 11h50 Time for reactions by Commissioner D. Reynders & discussion with the participants (30 min)
- 12h20 Next steps, by Commissioner D. Reynders (10 min)
- 12h30 End of the meeting

Lines to take

- Reaching our **sustainability objectives** is not possible without changing **companies' behaviour**. This requires **improvements to their governance.** A **voluntary approach** with reporting only has **not brought the necessary results, also because it is limited to a number of companies and lacked the necessary scale**.

- The **Commission's work programme** envisages the adoption of a **legislative proposal** on sustainable corporate governance for **the second quarter 2021**. **A public consultation** is currently open **until 8 February.**

- A **holistic approach** is crucial:
  - A horizontal **corporate due diligence obligation is needed** extending to the **supply chains** and covering **environmental, social and human rights impacts**;
  - It should be underpinned by **directors' duties** (including the clarification of the **duty of care** and a duty to embed sustainability in the business **strategy**);
  - **other** corporate governance instruments (such as stakeholder engagement, remuneration) are also to be considered.

- The [*DG FISMA led*] **public consultation on the renewed sustainable finance action plan** already shows overwhelming **general support** for action both regarding directors' duties and due diligence.

- **Both the Council and the European Parliament** have recently expressed support and **called for** a proposal on horizontal EU legislation on **due diligence,** with the **EP** also specifically **calling for** EU legislation **redefining the directors' duty of care**.

[Business case]

- The initiative **will improve businesses' resilience and ultimately their competitiveness**:
  - The clarification of the directors' duty of care would enable directors to better integrate in their decisions the long-term perspectives and sustainability factors and withstand undue short-term pressures. This should help the company to be more productive and innovative. A meta study compiling 2000 studies show that sustainability improves performance.
  - Due diligence rules will also bring **legal certainty and level playing field** in the whole European Union and result in more resilience.
- Companies with proper social and environmental impact management, including in their supply chain are notably more resilient in the current crisis.

[Scope: sectors, SMEs]

- We are planning an initiative that has a broad scope.

- The initiative will take into account the burden but also the **benefits** for **small and medium-sized enterprises**.

- **SMEs can also have large negative impacts** but they are typically exposed to less risk. As due diligence is risk- and context specific and requires reasonable steps to mitigate negative impact, it generally requires less efforts from SMEs.
- SMEs could also largely benefit from the rules (better risk management and resilience, competitiveness), from integrating into supply chains of EU companies and from the efforts made by larger companies.
- In addition, we are also considering how to **support SMEs** in their compliance efforts, notably by **guidance, tools or funding**.

[Civil liability for harm in supply chains]

- One of the **enforcement** mechanisms considered is based on **civil liability**.
- Human rights and environmental **harm occurs more often beyond tier one** of the supply chains, so covering only tier one suppliers would not sufficiently mitigate impact in the supply chains. Besides, such a rule would be very **easy to circumvent**, further **jeopardising the effectiveness** of the measure.
- However, the company should **not be liable** in case it is **not possible to foresee a specific risk** or to **reasonably address** a specific harm.

DEFENSIVES

Methodology of the Ernst and Young study to show short-termism:

- To measure the trend of short-termism the E/Y study compares the evolution of corporate **shareholder payouts** and **investments** relative to net income.
- As **the sustainability transition requires important investments** into resilience, sustainability, research, workforce etc., such a **methodology was considered appropriate** to measure whether **the market is sufficiently moving towards delivering on the transition itself.**
- The study clearly shows that a **growing predominant focus in corporate governance on short-term financial performance**.
- The EY study finds that in the last 30 years short-termism has been gradually increasing and has stabilised at high levels of shareholder payouts and low investment intensity. So it finds that **while 30 years ago companies mainly reinvested their profit** into long-term resilience and development, **today they largely redistribute it to shareholders** to the detriment of long-term sustainability.
- It is widely considered in literature that such trend **adversely impacts on the long-term competitiveness** of Western economies and is a **key barrier to the sustainability transition**.
- There are **other similar, independent studies** **depicting the same trend of short-termism and "investmentless growth"** across the Western world. The EY study also relied on an **extensive literature and regulatory review** and has identified **regulatory and market failures.**
- **Most recent studies from 2020** include a study was conducted for **31 OECD countries** (by Young Soo Lee, Han Sung Kim, Seo Hwan Joo) and revealed **growing short-termism in companies' technological innovation strategies** over the period 1990 to 2006 during which financialisation (the increasing influence of finance, including via the capital markets) advanced: emphasis on incremental innovation increased at the expense of radical innovation that would involve high-risk and long-term investment.
- Another study (by Burkart and Dasgupta) shows how **activist funds** – competing for investors themselves – can **foster short-termism in the companies** they invest in, by increasing payouts financed by debt, which will then also discourage value-creating interventions in economic downturns due to debt overhang.
- **The Commission continues to welcome any other studies** from stakeholders that are relevant for our impact assessment.
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