Study on directors’ duties and sustainable corporate governance

FINAL REPORT – ANNEX I
Study on directors’ duties and sustainable corporate governance

FINAL REPORT – ANNEX I
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<th>Abbreviation</th>
<th>Full Form</th>
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<tbody>
<tr>
<td>CDP</td>
<td>Carbon Disclosure Project</td>
</tr>
<tr>
<td>CEO</td>
<td>Chief Executive Officer</td>
</tr>
<tr>
<td>COACCH</td>
<td>CO-designing the Assessment of Climate Change costs project</td>
</tr>
<tr>
<td>COSO</td>
<td>Committee of Sponsoring Organisations of the Treadway Commission</td>
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<tr>
<td>CSR</td>
<td>Corporate Social Responsibility</td>
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<td>EC</td>
<td>European Commission</td>
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<tr>
<td>ERM</td>
<td>Enterprise Risk Management</td>
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<td>ESG</td>
<td>Environmental, Social and Governance</td>
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<td>ESMA</td>
<td>European Securities and Markets Authority</td>
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<td>EU</td>
<td>European Union</td>
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<tr>
<td>GAAP</td>
<td>Generally Accepted Accounting Principles</td>
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<td>GHGs</td>
<td>Greenhouse Gases</td>
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<td>GRI</td>
<td>Global Reporting Initiative</td>
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<td>IA</td>
<td>Investment Association</td>
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<tr>
<td>ICSA</td>
<td>The Institute of Chartered Secretaries and Administrators now known as Chartered Governance Institute</td>
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<tr>
<td>IR</td>
<td>Integrated Reporting</td>
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<tr>
<td>ISO</td>
<td>International Organisation for Standardisation</td>
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<td>KPI</td>
<td>Key Performance Indicator</td>
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<td>NGO</td>
<td>Non-Governmental Organisation</td>
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<tr>
<td>OECD</td>
<td>Organisation for Economic Co-Operation and Development</td>
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<td>PRI</td>
<td>Principles of Responsible Investment</td>
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<td>R&amp;D</td>
<td>Research and development</td>
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<td>SASB</td>
<td>Sustainability Accounting Standards Board</td>
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<td>SBTi</td>
<td>Science Based Targets initiative</td>
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<td>SDGs</td>
<td>Sustainable Development Goals</td>
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<td>SMART</td>
<td>Sustainable Market Actors for Responsible Trade</td>
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<td>SMEs</td>
<td>Small and Medium Enterprises</td>
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<td>UN</td>
<td>United Nations</td>
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<td>UNEP</td>
<td>United Nations Environment Programme</td>
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<td>US</td>
<td>United States</td>
</tr>
<tr>
<td>WBCSD</td>
<td>World Business Council for Sustainable Development</td>
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### EU Member States

- AT: Austria
- BE: Belgium
- BG: Bulgaria
- CY: Cyprus
- CZ: Czechia
- DE: Germany
- DK: Denmark
- EE: Estonia
- EL: Greece
- ES: Spain
- FI: Finland
- FR: France
- HR: Croatia
- HU: Hungary
- IE: Ireland
- IT: Italy
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<td>US</td>
<td>United States</td>
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Study on directors’ duties and sustainable corporate governance
## 1 Analysis of the possible effects of corporate short-termism on the attainment of the SDGs

<table>
<thead>
<tr>
<th>SDG #</th>
<th>Goal</th>
<th>How might corporate short-termism affect the achievement of the Goal?</th>
</tr>
</thead>
</table>
| 1     | End poverty in all its forms everywhere | Excessive focus on short-term financial performance and profit maximisation could lead companies to:  
  - **Neglect whether contractors pay a living wage** to their workers in their countries of operations  
  - **Neglect whether suppliers** across the supply chain **pay a living wage** to their workers  
  - **Not carrying out impact investments**, that is investing into projects that are aligned with company’s strategic objectives and generate a financial return (or at least a return of capital) while generating positive social and environmental impacts |
| 2     | End hunger achieve food security and improved nutrition and promote sustainable agriculture | Excessive focus on short-term financial performance and profit maximisation could lead companies (especially those in the agriculture and food and drink sectors) to:  
  - **Neglect the long-term economic consequences of climate change** and resource scarcity (e.g. increased primary product prices, lower profits, etc.) on their business sustainability  
  - **Neglect whether their farming practices or those by their suppliers are sustainable** in the long-term or not (e.g. in terms of preserving soil quality and fertility, saving water, reduced dependency on fertilisers and pesticides, etc.)  
  - Adopt supply chain policies and procedures that favour larger farms and **exclude smallholder farms from their supply base**  
  - **Neglect supply chain resilience** to climate change impacts (e.g. against increased frequency of extreme weather events, desertification, etc.)  
  - **Not investing in the development of crop varieties more resistant** to the effects of climate change |
| 3     | Ensure healthy lives and promote well-being for all at all ages | Excessive focus on short-term financial performance and profit maximisation could lead companies to:  
  - **Neglect unhealthy behaviour and life-styles** of their employees and in their supply chain  
  - **Not investing in health and safety programmes** or health services for managers, employees or local communities where companies source from  
  - **Not investing in the promotion of road traffic safety** for employees, suppliers and distributors |
<table>
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<tr>
<th>SDG #</th>
<th>Goal</th>
<th>How might corporate short-termism affect the achievement of the Goal?</th>
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<td>4</td>
<td><strong>Ensure inclusive and equitable quality education and promote lifelong learning opportunities for all</strong></td>
<td>Excessive focus on short-term financial performance and profit maximisation could lead companies to:</td>
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<tr>
<td></td>
<td></td>
<td>• <strong>Not investing sufficiently in workforce training and development</strong>, in light of both the global skills gap and ongoing and future technological changes affecting business and business ecosystems</td>
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<td></td>
<td></td>
<td>• <strong>Not investing into education and training related initiatives or partnerships</strong> (e.g. sponsored education programmes, apprenticeships, etc.) aimed at developing the skills that the business will require in the future</td>
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<tr>
<td>5</td>
<td><strong>Achieve gender equality and empower all women and girls</strong></td>
<td>Excessive focus on short-term financial performance and profit maximisation could lead companies to:</td>
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<td></td>
<td></td>
<td>• <strong>Not investing in sufficiently in diversity and inclusion policies</strong> (e.g. maternity and paternity policies to promote greater gender equality, initiatives to counter unconscious bias, introducing targets/quotas for under-represented sex in the board, etc.)</td>
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<tr>
<td></td>
<td></td>
<td>• <strong>Neglect risks related to gender inequalities</strong> and discrimination in their supply chain</td>
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<td>6</td>
<td><strong>Ensure availability and sustainable management of water and sanitation for all</strong></td>
<td>Excessive focus on short-term financial performance and profit maximisation could lead companies to:</td>
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<td></td>
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<td>• <strong>Neglect the water footprint of their operations</strong> or their activities along the supply chain and its impact on the natural water cycle and on stakeholders affected (such as local communities)</td>
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<td></td>
<td></td>
<td>• <strong>Neglect the economic consequences that the over-extraction of water</strong> will have on assets depending on water (e.g. water-intensive crops, manufacturing facilities, etc.)</td>
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<td>• <strong>Not investing to repair leakages or improve water efficiency</strong> in their operations (such as awareness programmes for employees on the reduction and reuse of water)</td>
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<tr>
<td></td>
<td></td>
<td>• <strong>Neglect whether suppliers</strong> along the supply chain <strong>provide clean water and good sanitation</strong> to their workers</td>
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<tr>
<td>7</td>
<td><strong>Ensure access to affordable, reliable, sustainable and modern energy for all</strong></td>
<td>Excessive focus on short-term financial performance and profit maximisation could lead companies to:</td>
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<td></td>
<td></td>
<td>• <strong>Not investing sufficiently into energy efficiency measures</strong></td>
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<td>• <strong>Neglect the negative impact of future price fluctuations</strong> (for instance, due to the increased price of carbon) on their energy supplies</td>
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<td></td>
<td></td>
<td>• <strong>Not moving towards sourcing their energy from renewables</strong>, especially as they become price-competitive</td>
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<tr>
<td></td>
<td></td>
<td>• <strong>Neglect the impact of their energy needs on local communities</strong> in their countries of operations</td>
</tr>
<tr>
<td>SDG #</td>
<td>Goal</td>
<td>How might corporate short-termism affect the achievement of the Goal?</td>
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</tbody>
</table>
| 8     | Promote sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all | Excessive focus on short-term financial performance and profit maximisation could lead companies to:  
- **Not considering sufficiently human rights** risks and impacts (e.g. modern slavery, human trafficking, child labour, etc.) in relation to their employees and supply chain  
- **Not including human rights considerations into** supplier and third-party due diligence practices  
- **Not investing sufficiently into** policies and programmes aimed at promoting workplace health and safety, including in the supply chain  
- **Not investing sufficiently into policies and programmes aimed at** the employment, retention and reward of **people with disabilities** |
| 9     | Build resilient infrastructure, promote inclusive and sustainable industrialisation and foster innovation | Excessive focus on short-term financial performance and profit maximisation could lead companies to:  
- **Not investing sufficiently into R&D**, technological innovation, and innovative business models to ensure long-term sustainability  
- **Not spending sufficiently for the renovation or the building of infrastructures** more resilient to the effects of climate changes  
- **Not investing in infrastructures that would benefit both the business and the economic development of local communities** (for instance, roads built through private-public partnerships in developing countries where the companies operate) |
| 10    | Reduce inequality within and among countries | Excessive focus on short-term financial performance and profit maximisation could lead companies to:  
- **Adopt base erosion and profit shifting (BEPS) tax planning strategies** to avoid paying taxes, which deprives developing countries of revenues and contributes to global inequality among countries  
- **Increase (rather than close) pay differentials** between executives and employees  
- **Pay low wages** to their employees, in particular interns and apprentices  
- **Not investing sufficiently into equal opportunity policies** that can benefit foreign workers and contribute to social mobility |
| 11    | Make cities and human settlements inclusive, safe, resilient and sustainable | Excessive focus on short-term financial performance and profit maximisation could lead companies to:  
- **Not considering the environmental impacts of transport emissions and pollution** in the urban areas where they operate (and internalise them as a cost)  
- **Not investing into green buildings** for their premises  
- **Not being adequately prepared for climate change impacts in urban locations** (e.g. through resilient building design, employee training in case of disasters, etc.) |
<table>
<thead>
<tr>
<th>SDG #</th>
<th>Goal</th>
<th>How might corporate short-termism affect the achievement of the Goal?</th>
</tr>
</thead>
</table>
| 12    | Ensure responsible consumption and production patterns | Excessive focus on short-term financial performance and profit maximisation could lead companies to:  
• Not embracing business model focused on long-term sustainable growth through the efficient use and re-use of scarce resources  
• Not setting measurable targets in relation to energy and resource intensity of their production  
• Reduce investments into R&D to find innovative ways to reuse resources, regenerate natural capital, and eventually decouple business growth from energy and resource use  
• Not contributing substantially to circular economy, either in their operations or through consumer awareness raising campaigns on waste reduction |
| 13    | Take urgent action to combat climate change and its impacts | Excessive focus on short-term financial performance and profit maximisation could lead companies to:  
• Not reducing their reliance on brown energy and their contribution to GHG emissions, either direct or indirect  
• Neglect the economic impacts of more frequent and severe climate events (e.g. drought, heat waves, wildfires, sea level rise and floods, etc.) on their business and on their supply chain (e.g. on production facilities, operations, logistics, supply, distribution, etc.) |
| 14    | Conserve and sustainably use the oceans, seas and marine resources for sustainable development | Excessive focus on short-term financial performance and profit maximisation could lead companies to:  
• Not investing into opportunities to reduce the use of plastics (such as reducing plastic packaging size) or to re-use or recycle plastics  
• Not taking the necessary steps to contribute to a systematic change and move towards a circular plastics economy  
• Neglect the impacts of their operations on marine and coastal environments and ecosystems  
• For fisheries, neglecting the economic consequences of overfishing on the long-term sustainability of their business |
| 15    | Protect, restore and promote sustainable use of terrestrial ecosystems, sustainably manage forests, combat desertification, halt and reverse land degradation and halt biodiversity loss | Excessive focus on short-term financial performance and profit maximisation could lead companies to:  
• Neglect the negative impacts of their operations or supply chain on forests and biodiversity in terrestrial ecosystems (e.g. deforestation, biodiversity loss, etc.)  
• Neglect the economic impacts of biodiversity loss, deforestation and land degradation on their business (especially for industries that rely heavily on ecosystem services and habitats, such as tourism)  
• Not investing into policies aimed at reducing impacts on forests (e.g. reduce paper waste, sourcing certified sustainable soy, palm oil, paper, etc.) |
<table>
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<th>SDG #</th>
<th>Goal</th>
<th>How might corporate short-termism affect the achievement of the Goal?</th>
</tr>
</thead>
</table>
| 16    | Promote peaceful and inclusive societies for sustainable development, provide access to justice for all and build effective, accountable and inclusive institutions at all levels | Excessive focus on short-term financial performance and profit maximisation could lead companies to:  
  - **Not being fully transparent in relation to material ESG issues** in their corporate reporting  
  - **Not being fully transparent in relation to corporate tax**  
  - **Not engaging their stakeholders effectively** on non-financial risks and opportunities associated with their operations  
  - **Neglect the impact of their activities on peace and security** across the world (for instance, companies in the financial sector involuntarily facilitating the funding of conflicts or terrorists) |
| 17    | Strengthen the means of implementation and revitalise Global Partnership for Sustainable Development | Excessive focus on short-term financial performance and profit maximisation could lead companies to:  
  - **Not partnering with other stakeholders** (e.g. governments, businesses, NGOs, international organisations, education and training providers, etc.) **to set up or participate in broad multi-stakeholder coalitions** aimed at addressing one or more SDG or specific target                                                                                      |


2 GENERAL SCREENING OF THE SITUATION IN EU28 MEMBER STATES

This Annex provides a high-level picture of corporate governance regulatory framework and self-regulatory measures in EU28 Member States,\(^1\) based on a preliminary review of national laws, regulations and corporate practices performed by the network of national corporate law/corporate governance experts during the preparatory task. This is an update of the version included in the Inception report, following a more detailed review of national legislation and relevant literature in the 12 Member States selected for in-depth analysis.

2.1 Regulatory frameworks

Key findings

- The law disciplines directors’ duties and liabilities in all Member States. Specific sustainability-related obligations for directors are enshrined in the law in just a few Member States, except for the publication of non-financial data, which is codified in most EU countries.
- National regulatory frameworks do not provide for a requirement to include environmental and social purposes within companies’ business plans. Similarly, national legislation in the Member States does not appear particularly prescriptive as concerns stakeholders’ involvement in shareholders’ meetings and in the design and oversight of corporate sustainability strategy.
- In most Member States, directors are liable towards both shareholders and other stakeholders (e.g. employees), and the law recognises stakeholders’ rights to hold directors accountable for their decisions. But only in a minority of Member States the law defines accountability obligations related to sustainability.
- Board remuneration is regulated by the law in the large majority of Member States, and in just a few EU countries board members’ pay is linked to specific sustainability parameters.

Directors’ duties\(^2\)

<table>
<thead>
<tr>
<th>DIRECTORS’ DUTIES</th>
<th>AT</th>
<th>BE</th>
<th>BG</th>
<th>CY</th>
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<td>Are directors legally bound to identify long-term environmental, social, and governance risks to the company’s interests?</td>
<td>Yes</td>
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<td>Are directors legally bound to publish a sustainability strategy?</td>
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<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
</tbody>
</table>

Directors’ duties and liabilities are generally disciplined by the law in all Member States. Legal provisions in this regard apply to all companies, regardless of their type (listed, non-listed), size, or sector of operation.

Directors’ sustainability practices are rarely defined by the law. Specifically, there is a legal obligation for board members to identify long-term ESG risks to the company’s sustainability in a slight majority of Member States (17), and in a considerable number of

---

1 Please consider that UK was still an EU Member States when this analysis was performed, and as such was included in this general screening.

2 In this table and the following ones, ”NA” stands for no information available.
Member States (11) there is no such legal requirement. Only in few Member States (9) directors are legally bound to act in respect of ESG sustainability.

The “interest of the company” is defined by the law only in few Member States (7), while in the vast majority (21) the law does not provide for a definition.

While in all Member States (28) national regulatory frameworks require companies to disclose non-financial data, in most Member States (21) there is no legal obligation for directors to publish a sustainability strategy and directors are bound by law to publish a sustainability strategy in only 5 Member States.

**Company’s purposes**

<table>
<thead>
<tr>
<th>COMPANY’S PURPOSE</th>
<th>AT</th>
<th>BE</th>
<th>BG</th>
<th>CY</th>
<th>CZ</th>
<th>DE</th>
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<th>SE</th>
<th>SI</th>
<th>SK</th>
<th>UK</th>
</tr>
</thead>
<tbody>
<tr>
<td>Are profit-making companies legally bound to include environmental purposes (e.g., development of new low-emission products and services, access to new markets, etc.) in their business plan?</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
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<td>Yes</td>
<td>No</td>
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<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Are profit-making companies legally bound to include social purposes (e.g., improvement of working conditions, investments in human capital/skills, etc.) in their business plan?</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
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<td>No</td>
<td>Yes</td>
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<td>NA</td>
<td>Yes</td>
<td>NA</td>
<td>No</td>
<td>No</td>
</tr>
</tbody>
</table>

In most Member States (19, the exception being BG, CZ, FR, HR, IT, PT and SI), national regulatory frameworks do not include provisions that require profit-making companies to include environmental and/or social purposes in their business plans. On the opposite, companies are legally bound to take account of environmental and social purposes in their business plans in four Member States (CZ, EL, FR, SI).

**Stakeholder involvement**

<table>
<thead>
<tr>
<th>STAKEHOLDER INVOLVEMENT</th>
<th>AT</th>
<th>BE</th>
<th>BG</th>
<th>CY</th>
<th>CZ</th>
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<th>SE</th>
<th>SI</th>
<th>SK</th>
<th>UK</th>
</tr>
</thead>
<tbody>
<tr>
<td>Is stakeholder participation to shareholders meeting disciplined by the law?</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
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<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Is stakeholder involvement in the design of the sustainability strategy disciplined by the law?</td>
<td>NA</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
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<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>NA</td>
</tr>
<tr>
<td>Is stakeholder involvement in the oversight of the sustainability strategy disciplined by the law?</td>
<td>NA</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
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<td>No</td>
<td>NA</td>
</tr>
</tbody>
</table>

In roughly one third of countries considered (11) the participation of stakeholders to shareholders meetings is regulated by the law in some ways. However, in the majority of Member States (17) there is not a specific legislative provision on this matter. Similarly, in the vast majority of Member States the involvement of stakeholders in the design and oversight on the implementation of company’s sustainability strategy is not defined in the law, the exception being FR as concerns the oversight of strategy implementation.

**Enforcement of the duty of care**

<table>
<thead>
<tr>
<th>ENFORCEMENT</th>
<th>AT</th>
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<th>BG</th>
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<th>UK</th>
</tr>
</thead>
<tbody>
<tr>
<td>Are directors liable towards shareholders?</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
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<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Are stakeholders’ rights to hold directors accountable for their decisions disciplined by the law?</td>
<td>NA</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
<td>No</td>
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<td>No</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Is board accountability towards sustainability-related aspects disciplined by the law?</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
<td>No</td>
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<td>Yes</td>
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<td>Yes</td>
</tr>
</tbody>
</table>

Shareholders can seek enforcement actions against board members in the majority of Member States (24), and in more than half Member States (18) also stakeholders (other than shareholders) can. Moreover, stakeholders’ rights to hold directors accountable for their decisions are disciplined by the law in the majority of Member States (22). Board accountability for sustainability-related decisions is disciplined by the law only in a minority of Member States (10).
The remuneration of the members of the board is disciplined by the law in almost all Member States (26, except for CY and DE), and in only 5 Member States (AT, BE, CZ and, only for listed companies, DK) remuneration is linked to precise sustainability parameters by the law.

2.2 Self-regulatory measures

- Although directors are in general provided with guidance in relation to the identification of long-term sustainability risks and the promotion of sustainability in the companies, the adoption of standardised ESG risk management systems seems rare.
- Guidelines on the disclosure of corporate non-financial data are more common than guidance on sustainability strategy and targets reporting.
- Practices concerning the setting of sustainability targets are heterogeneous and poorly linked to international sustainability objectives (e.g. UN SDGs).
- Similarly, stakeholders’ involvement in boards’ decision-making and oversight activities appears limited in most Member States.
- The practice of linking directors’ remuneration to long-term sustainability goals and claw-back clauses is rarely includes in self-regulatory measures in most EU countries.

In the majority of Member States there are other non-regulatory documents (e.g. Codes of Conduct, internal policies, Article of associations etc.) that give indications to companies on the definition of directors’ duties (19) and on the identification of long-term risks (15). Moreover, in almost half of the Member States (13), guidance is also provided on the promotion of sustainability by directors.

In few Member States guidance is also provided on directors’ liability towards stakeholders (9), on the inclusion of an internal sustainability committee (5) and on the pursuit of public purposes (3). The connection with standardised systems of risk management, such as OHSAS (6) and SA 8000 (3), is also limited.

Disclosure

In the majority of Member States there are other non-regulatory documents (e.g. Codes of Conduct, internal policies, Article of associations etc.) that give indications to companies on the definition of directors’ duties (19) and on the identification of long-term risks (15). Moreover, in almost half of the Member States (13), guidance is also provided on the promotion of sustainabilit
In the majority of Member States (18) there are guidelines for companies on the publication of non-financial data. Less common are documents pushing towards the publication of sustainability reports (10) and the external auditing of non-financial data (6).

**Strategy and targets**

| STRATEGY & TARGETS | AT | BE | BG | CY | CZ | DE | DK | EE | EL | ES | FI | FR | HR | HU | IE | IT | LT | LU | LV | MT | NL | PL | PT | RO | SE | SI | SK | UK |
|--------------------|----|----|----|----|----|----|----|----|----|----|----|----|----|----|----|----|----|----|----|----|----|----|----|----|----|----|----|----|----|
| Setting of sustainability targets | NA | No | NA | NA | Yes | NA | NA | Yes | NA | NA | Yes | NA | NA | No | No | No | No | Yes | No | Yes | No | Yes | No | NA | NA | No | No | NA | Yes | Yes |
| Linking of internal goals to UN Sustainable Development Goals | NA | No | NA | NA | No | NA | NA | No | No | No | Yes | No | NA | No | No | No | No | No | No | No | No | NA | No | No | No | No | NA | No | No | No |
| Linking of internal targets to UN Paris Agreement targets | NA | No | NA | NA | No | NA | NA | No | No | No | Yes | No | NA | No | No | No | No | No | No | No | No | No | NA | No | No | No | NA | No | No | No |
| Linking of internal targets to those of the UN Sendai Framework for Disaster Risk Reduction | NA | No | NA | NA | No | NA | NA | No | No | No | No | NA | NA | No | No | No | No | No | No | No | No | No | No | No | No | NA | No | No | No | No |

Examples of guidelines for companies on how to define and set sustainability targets have been identified in just a few Member States (7). Reference to sustainability objectives identified at international level for defining internal sustainability targets seems also quite limited, with the UN SDGs and the UN Paris Agreement being referred in just in 2 Member States (HR, LU).

**Stakeholder involvement**

| STAKEHOLDER INVOLVEMENT | AT | BE | BG | CY | CZ | DE | DK | EE | EL | ES | FI | FR | HR | HU | IE | IT | LT | LU | LV | MT | NL | PL | PT | RO | SE | SI | SK | UK |
|--------------------------|----|----|----|----|----|----|----|----|----|----|----|----|----|----|----|----|----|----|----|----|----|----|----|----|----|----|----|----|----|
| Involvement of stakeholders in decision-making processes | NA | Yes | No | No | Yes | NA | NA | No | No | No | Yes | No | NA | No | No | No | No | No | No | No | No | No | NO | Yes | No | Yes | NA | No |
| Representation of stakeholders in the Board of Directors | NA | Yes | NA | No | Yes | NA | NA | Yes | No | No | No | No | No | No | No | No | No | No | No | No | No | No | No | No | No | Yes | No | No | No |
| Involvement of stakeholders in sustainability committees | NA | Yes | NA | No | No | NA | NA | NA | No | No | No | No | No | No | No | No | No | No | No | No | No | No | No | No | No | Yes | No | No | No |

The involvement of stakeholders in the decision-making process of a company and their direct representation in the board of directors are covered by non-regulatory documents in just 2 Member States (BE, RO). Moreover, provisions on stakeholders’ involvement in sustainability committees are present in non-regulatory documents in just 2 Member States (BE, RO).

**Remuneration**

| REMUNERATION | AT | BE | BG | CY | CZ | DE | DK | EE | EL | ES | FI | FR | HR | HU | IE | IT | LT | LU | LV | MT | NL | PL | PT | RO | SE | SI | SK | UK |
|---------------|----|----|----|----|----|----|----|----|----|----|----|----|----|----|----|----|----|----|----|----|----|----|----|----|----|----|----|----|----|
| Linking of directors’ remuneration to the achievement of sustainability goals | NA | Yes | NA | No | No | NA | NA | Yes | Yes | Yes | No | No | No | No | No | No | No | No | Yes | No | No | No | No | NA | Yes | No | No | No |
| Inclusion of claw-back clauses for remuneration (contractual provision whereby money already paid to an employee must be returned to an employer with a penalty) | NA | No | NA | No | Yes | NA | NA | NA | NA | Yes | No | No | No | No | No | No | No | No | No | No | No | No | No | NA | No | No | No | Yes |

Linking director’s remuneration to the achievement of sustainability goals is a practice covered by guidance documents in a few Member States (7), while it is generally absent in many EU countries (12). Similarly, claw-back clauses are not covered in the majority of Member States (15), except for 3 EU countries (CZ, ES, UK).
### 3 Analysis of Gaps in the Estimation of Sustainability Risks by Listed Companies

#### 3.1 Garment

<table>
<thead>
<tr>
<th>Areas of analysis</th>
<th>Detail</th>
<th>Main findings and supporting evidence</th>
</tr>
</thead>
</table>
| Sustainability risks under consideration | Environmental | Based on all evidences gathered (survey - 2 responses by sectorial companies - interviews - one NGO, two business organisations and one company - and documentary review), the three most relevant environmental risks to which the garment sector is exposed are:  
- raw material sourcing, which implies also the need to consider the implications with an extended view along the whole value chain;  
- climate change, which can impact both on physical assets integrity and on raw materials availability for sourcing;  
- regulatory compliance, considering in particular potential new regulations concerning the use of hazardous materials. The environmental regulatory system in Europe is already quite developed (e.g. REACH for chemicals use), while in other countries the impacts of new environmental regulations could be relevant, thus generating indirect impacts on European companies throughout the value chain. |
| Social | | Based on all evidences gathered (survey - 2 responses by sectorial companies - interviews - one NGO, two business organisations and one company - and documentary review), the most relevant social risks to which the garment sector is exposed are related to labor practices and human rights along the entire value chain (e.g. workers' health and safety, freedom of associations, respect of human rights and human rights assessment / due diligence along the supply chain).  
As per the environmental regulatory framework, also for human rights and labor practices, the European context is one of the most developed, therefore the challenge for European companies is to manage risks along their value chain, especially when they primarily source from extra EU Countries. In this scenario, an additional risk for the companies in this sector derives from the inadequacy of audit and due diligence processes put in place (as highlighted in the CCC report\(^3\)), as "The quality and accuracy of third-party monitoring reports depend largely on the methodology used in the assessments, the independence of the assessors from the factory and the apparel company, and the weight given to testimonies from workers and other interested parties. These tools are not sufficient in and of themselves to detect all instances of abuse, unauthorised subcontracting, and other problems."
Initiatives such as the "Accord on Fire and Building Safety in Bangladesh" (the Bangladesh "Accord"), where there is an accountability framework – which includes |

\(^3\) Clean Clothes Campaign (CCC) (2017), ‘Follow the Thread. The Need for Supply Chain Transparency in the Garment and Footwear Industry’.
### Areas of analysis
<table>
<thead>
<tr>
<th>Detail</th>
<th>Main findings and supporting evidence</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financing</td>
<td>On managing the specific risks of fire and building safety in Bangladesh, confirm the rising attention of the sector with respects to the management of social risks along the value chain.</td>
</tr>
<tr>
<td>Economic</td>
<td>Based on the documentary review and on the interview carried out to one business organisation, there is a rising attention and awareness of potential economic risks which can derive both from evolving business activities/models and from pressures and risks related to environmental and social issues. The cost of resources and technological innovation could impact on business activities and on profitability; for instance, according to Euratex4 &quot;The high cost of fiber sorting and limits in applicable technologies for mechanical/chemical recycling are considered as an obstacle to scaling up. Private and public investment combined with appropriate regulatory policy and business will greatly help the transition from linear to circular economy&quot; Furthermore, risks related to environmental and social compliance, as described above, could have economics impacts (thus could represent an economic risk) in case of the release of new national or internationals laws or framework. Finally, according to the documentary review and the interview carried out with a business organisation, the sector is increasingly aware of the potential economic impacts coming from reputational damages / business disruption arising from negative episodes along the supply chain.</td>
</tr>
<tr>
<td>Alignment of risks identified with relevant sustainability topics</td>
<td>Based on the activities carried out and on the analysis of impacts, typically, the garment sector identifies risks along the entire value chain that are aligned with the related impacts and topics of its business, also because companies receive pressures primarily from end consumers and voluntarily reacts to mitigate impacts and related risks.</td>
</tr>
</tbody>
</table>

### Methodology used to identify and prioritise risks
| Engagement and involvement of corporate functions and collaboration between sustainability and risk functions | - |
| Integration of sustainability and ESG risks in the ERM model | Based on all evidences gathered and on interviews carried out (one NGO, two business organisations and one company), the scenario on the evaluation of ESG risks and their integration in the ERM model appears to be very different from company to company, considering the dimensions and maturity of the companies themselves. According to the responses (2 respondents) to the survey and to the interviews, there are some companies which are currently integrating ESG risks and issues (starting from climate change) in the ERM, especially big companies and international groups, which have been dealing with sustainability for several years. |

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4 The European apparel and textile confederation (EURATEX) (2019), 'Policy Brief. Prospering in the circular economy'.
Study on directors’ duties and sustainable corporate governance

<table>
<thead>
<tr>
<th>Areas of analysis</th>
<th>Detail</th>
<th>Main findings and supporting evidence</th>
</tr>
</thead>
<tbody>
<tr>
<td>Boundaries of the process for the identification of risks (supply chain, lifecycle of the project)</td>
<td>On the opposite side, in SMEs there is often a dedicated person / function who is in charge of mapping and monitoring ESG risks (e.g. the responsibility in some cases is given directly to the CEO).</td>
<td></td>
</tr>
<tr>
<td>Most critical issues that the companies encounter in the process of integrating environmental and social-related risks and impacts into the Enterprise Risk Management and into corporate strategies</td>
<td>As stated above and as confirmed by the documentary review and by the interviews carried out (one business organisation), typically the garment sector identifies risks along the entire value chain, considering the frequent outsourcing of processes and raw materials production. However, identifying and managing risks along the value chain is challenging as, for example, tier 2 suppliers can’t be directly controlled and Extended Producer Responsibility may impact on businesses if not well addressed⁴. Anyway, according sectorial NGOs, the attention on the ESG risks is unevenly distributed along the whole value chain.</td>
<td></td>
</tr>
<tr>
<td>Evaluation and estimation of the potential impacts linked to the identified risks</td>
<td>According to the evidences gathered (survey - 2 respondents - interviews with two business organisation and one NGO), the most critical issues in identifying, managing and integrating ESG risks into business processes are related to: - the difficulties in quantitative assessment of the ESG-related risks; in general, companies are addressing sustainability-related risks on a strategic/high level, but there is still room for improvement as concerns measurement and monitoring; - different time horizon between ESG-related risks and business ones; - lack of collaboration among different functions; - presence of different actors, not only internally (e.g. different functions), but also externally (supply chain); - prevalence of business priories, instead of sustainability ones. However, desk analysis reveal that Companies are starting moving towards a more long-term perspectives in order to better manage such risks.⁵</td>
<td></td>
</tr>
</tbody>
</table>

KPIs used to assess environmental risks
Based on the responses above and the responses related to impacts, the definition of KPIs to measure and assess environmental topics is more focused on impacts and on certifications, than it is on risks. An example is Kering EP&L (Environmental Profit and Loss), a tool which can be used to evaluate and quantify environmental impacts of the Company’s activities. The results of such evaluation are annually published by the Company.

KPIs used to assess social risks
As per environmental topics, the definition of KPIs to measure and assess social aspects is more focused on impacts, than it is on risks. Anyway, a dedicated social metric is the Corporate Human Rights Benchmark (CHRB), a collaborative effort by business and human rights organisations and investors, which developed a public scorecard for the human rights practices of apparel, agricultural,

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⁵
### Areas of analysis | Detail | Main findings and supporting evidence
--- | --- | ---
KPIs used to assess economic risks |  | and extractive companies. This kind of tool could be an input to evaluate the likelihood of potential social risks for companies.

#### Level of involvement of the board in the identification and evaluation of the risks

<table>
<thead>
<tr>
<th>Detail</th>
<th>Main findings and supporting evidence</th>
</tr>
</thead>
<tbody>
<tr>
<td>Involvement in the identification and evaluation</td>
<td>Based on the survey (2 respondents) and the interviews (one NGO, two business organisations and one company), at high level, the Board is typically involved in the process of identification of ESG-related risks and impacts, supervising lower dedicated functions. However, it does not mean that Board members are sustainability experts or have sustainability specific competencies. In some cases, the regulation requires the Boards to take responsibility of some sustainability-related topics disclosures (e.g. in UK, a Board member is legally responsible for the modern Slavery Act of its Company). There are already best cases in which the head of Sustainability is actively part of the executive committee and there is sustainability-related remuneration on executives.</td>
</tr>
</tbody>
</table>

#### Disclosure of risk related information and sustainability strategy

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<tr>
<th>Detail</th>
<th>Main findings and supporting evidence</th>
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<tbody>
<tr>
<td>Actual disclosure and type of document used</td>
<td>Normally, Financial annual reports and Non-Financial Declarations are official documents in which Companies disclose about sustainability risks and impacts, together with other documents, as CDP Guidelines, GRI Standards and TCFD recommendations which are voluntarily taken into account by garment sector Companies. Those kind of documents emerged also from the online survey (2 respondents). As stated above and based on documentary review and interviews, the sector is highly exposed to requests for transparent and constant disclosure, considering also the close relationship with final consumers.</td>
</tr>
</tbody>
</table>

### 3.2 Telecommunications

#### Areas of analysis | Detail | Main findings and supporting evidence
--- | --- | ---
Sustainability risks under consideration | Environmental | Exposure to climate change risks is modest and largely based on the effect extreme weather such as hurricanes, tornadoes, ice storms or flooding would have on telecoms operating infrastructure and customers. This is stated within the sectoral documentary review⁶, while one respondent to the survey (business organisation) highlighted climate change as one of the risk factors for the sector. According to the survey, additional risks could be related to non-compliance with environmental laws and regulation. According to ESG Industry Report Card:⁶ Telecommunications, demographic shifts and megatrends like social media and connectivity are key social exposures that affect consumer demand for telecoms. The ongoing debates over the societal impact of excessive use of social media, particularly among younger users, and the effect of misinformation in the media could create social pressure to reduce or change usage |

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<th>Areas of analysis</th>
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<th>Main findings and supporting evidence</th>
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</table>
| Economic          |        | patterns: moreover, any incidents related to data security and systems stability in the telecoms sector will also be highly visible, given the sector’s extensive reach (risks related to customer privacy have also been confirmed by the responses to the on-line survey). Human capital management is another key social risk, since telecom companies also typically have large workforces that are significantly unionised. According to Focus on ESG risks’ crucial in the telecom sector it is “vital for telecom companies to recognize the importance of personnel development and the need to retain talented staff”.
Another nascent, but notable, social risk stems from potential health concerns regarding exposure to electromagnetic frequency (EMF) radiation from high-frequency fifth-generation (5G) telecom equipment and devices. According to the two respondents to the survey (one company and one business organisation), the main social risks are related to: non-compliance with human rights related laws and regulations, customer privacy and employees’ health and safety. According to the CDC sector profile, the main economic risks that the telecom companies may face are:
- Prosecution or fines if workers or contractors are injured or killed.
- Damage to/loss of the company’s assets with potentially costly transmission outages.
- Increased insurance premiums and potential legal claims can result from poor OHS practices.
- Low workforce morale and erosion of trust or industrial action as a result of poor practices can lead to higher staff turnover, additional training and recruiting costs and reputational damage.
- Use of security forces can present a risk for workers and local communities if security personnel are not carefully selected, trained and monitored. This can affect the company’s operations and reputation.
- Fines and penalties can be imposed for non-compliance with national pollution prevention standards, especially for hazardous materials/waste management and air emissions.
- Excessive expenditure on energy supply.
- Excessive expenditure on management of solid waste.
Actually, these risks are all related to, and consequences of, the environmental and social risks identified by the stakeholders involved through the online survey and the documentary review. |
<p>| Alignment of risks identified with relevant sustainability topics |        | Based on the results of the risks and impacts analysis, there seems to be alignment between the ESG risks and the sustainability topics/impacts of the sector for what concerns climate change, while social aspects are less interrelated. For instance, one of the main economic risks identified is prosecution or fines if workers or contractors are injured or killed. This risk is linked to the social risk of non-compliance with human rights related laws and regulations. |</p>
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<tr>
<th>Areas of analysis</th>
<th>Detail</th>
<th>Main findings and supporting evidence</th>
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<tbody>
<tr>
<td><strong>Methodology used to identify and prioritise risks</strong></td>
<td>Engagement and involvement of corporate functions and collaboration between sustainability and risk functions</td>
<td>The most recognised risk is related to customer privacy, which did not result from the impact analysis.</td>
</tr>
<tr>
<td></td>
<td>Integration of sustainability and ESG risks in the ERM model</td>
<td>According to both the stakeholders involved in the survey (one business organisation and one company), the process for the identification and evaluation of ESG-related risks is done within the Enterprise Risk Management. No evidence has been collected from the documentary review on this topic, so affordable and general conclusion can’t be drawn.</td>
</tr>
<tr>
<td></td>
<td>Boundaries of the process for the identification of risks (supply chain, life cycle of the project)</td>
<td>The survey output highlighted that the main issues met by telecom companies for the integration of ESG aspects within the ERM are the difficulties in their quantitative assessment and in their identification through the value chain. No evidence has been collected from the documentary review on this topic, so affordable and general conclusion can’t be drawn.</td>
</tr>
<tr>
<td><strong>Evaluation and estimation of the potential impacts linked to the identified risks</strong></td>
<td>KPIs used to assess environmental risks</td>
<td></td>
</tr>
<tr>
<td></td>
<td>KPIs used to assess social risks</td>
<td></td>
</tr>
<tr>
<td></td>
<td>KPIs used to assess economic risks</td>
<td></td>
</tr>
<tr>
<td><strong>Level of involvement of the board in the identification and evaluation of the risks</strong></td>
<td>Involvement in the identification and evaluation</td>
<td>According to both the stakeholders involved through the online survey (one company and one business organisation), the companies' boards are involved mainly in the following activities: - Define sustainability priorities - Ensure that the company’s sustainability strategy and performance are communicated at annual meetings and to investors - Oversee the implementation of the strategy and ensure that key targets are being met - Set measurable sustainability targets. As stated by Sustainability in Global Telecommunications Industry executives are moving towards actions for new smart and green technologies and for deploying research and development of scarce resources: &quot;without their participation in the supply and demand of smart and green technologies, sustainable initiatives are doomed&quot;.</td>
</tr>
<tr>
<td><strong>Disclosure of risk related</strong></td>
<td>Actual disclosure and type of document used</td>
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### 3.3 Construction

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<tr>
<th>Areas of analysis</th>
<th>Detail</th>
<th>Main findings and supporting evidence</th>
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</thead>
<tbody>
<tr>
<td><strong>Sustainability risks under consideration</strong></td>
<td>Environmental</td>
<td>The analysis of the documentation available for the construction sector reveals that Climate Change is definitely the most critical environment-related risk to manage (S&amp;P,(^6) FIEC(^9)). In particular, buildings are directly exposed to climate-related risks (storms, hurricanes, etc.) which can interrupt operations or damage equipments(^8). That is why the FIEC, states that &quot;new and existing buildings and infrastructure need to be climate-proofed&quot; in its Manifesto 2019-2024,(^10) clearly addressing this issue as one of the most critical and challenging also in the future. Furthermore, the FIEC, in its document titled &quot;10 proposals to tackle climate change&quot;,(^11) affirms that the role of the construction sector must be to &quot;help to minimise the impact of climate change by maintaining permanent access to [...] services&quot; such as mobility, water, communication, information, accommodation, lighting, etc. Therefore, according to the sectorial desk analysis, climate change - and related direct consequences - are currently recognised as key risk within the construction sector, and companies actually tackle it as opportunity to innovate and offer safer solutions.</td>
</tr>
<tr>
<td>Social</td>
<td></td>
<td>Based on the sectorial desk analysis, the main social risk for the construction industry is health and safety management, that can vary in relation to the geography and the local legislation where buildings are located.(^8) According to the FIEC Manifesto 2019-202410 &quot;The &quot;zero accidents&quot; target in the field of Occupational Safety and Health must remain the main objective for a well-functioning labour market&quot;. Furthermore, according to FIEC,(^9) construction sector companies are directly affected by the lack of skilled employees and thus the available workforce could be limited in the near future in terms of competences and affordability.</td>
</tr>
<tr>
<td>Economic</td>
<td></td>
<td>The information gathered is not sufficient to elaborate a judgement on this aspect.</td>
</tr>
<tr>
<td>Alignment of risks identified with relevant sustainability topics</td>
<td></td>
<td>In general terms, the analysis of available sectorial documentation shows alignment of risks identified with relevant sustainability topics. In addition, FIEC considers it</td>
</tr>
</tbody>
</table>

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\(^9\) FIEC, European Construction Industry Federation (2018), 'Sustainability in the built environment'.
\(^10\) FIEC, European Construction Industry Federation, EIC, European International Contractors, 'Construction Manifesto EU term 2019-2024'.
\(^11\) FIEC, European Construction Industry Federation, FFB, Federation Française du Batiment, '10 proposals to tackle climate change'.
### Areas of analysis | Detail | Main findings and supporting evidence
--- | --- | ---
Methodology used to identify and prioritise risks | Engagement and involvement of corporate functions and collaboration between sustainability and risk functions | The information gathered is not sufficient to elaborate a judgement.
 | Integration of sustainability and ESG risks in the ERM model | The information gathered is not sufficient to elaborate a judgement.
 | Boundaries of the process for the identification of risks (supply chain, life cycle of the project) | The information gathered is not sufficient to elaborate a judgement.
 | Timeline to evaluate the likelihood and impact of the risks identified and link with the timeline used to evaluate financial and business risks | -
 | Frequency for updating the identification and evaluation of risks | -
 | Most critical issues that the companies encounter in the process of integrating environmental and social-related risks and impacts into the Enterprise Risk Management and into corporate strategies | The CICA - Confederation of International Contractors' associations, in its position paper on Sustainable Construction,\(^2\) states that "There are numerous barriers to first design, then build and finally operate, works that incorporate elements and technologies that allow to obtain in their useful life cycle, better performance and lower energy consumption and environmental impacts", among them: the limited perspective adopted by the actors involved in projects, who do not approach environmental-related subjects from the earlier stages of project and design; the local legislative differences that do not make it easy to generate models that might be applicable and standardised within the sector. However, the information gathered is not sufficient to elaborate a judgement for the entire construction sector.

Evaluation and estimation of the potential impacts linked to the identified risks | KPIs used to assess environmental risks | The information gathered is not sufficient to elaborate a judgement.
 | KPIs used to assess social risks | The information gathered is not sufficient to elaborate a judgement.
 | KPIs used to assess economic risks | The information gathered is not sufficient to elaborate a judgement.

Level of involvement of the board in the identification and | Involvement in the identification | The information gathered is not sufficient to elaborate a judgement.
 | Involvement in the evaluation | The information gathered is not sufficient to elaborate a judgement.

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\(^2\) CICA, Confederation of International Contractors' associations, 'Position paper on sustainable construction' available at [link](#).
### Areas of analysis | Detail | Main findings and supporting evidence
--- | --- | ---
**evaluation of the risks** |  |  
**Disclosure of risk related information and sustainability strategy** | Actual disclosure and type of document used | The information gathered is not sufficient to elaborate a judgement.

### 3.4 Power and utilities

#### Areas of analysis | Detail | Main findings and supporting evidence
--- | --- | ---
**Sustainability risks under consideration** | Environmental | Based on the sectorial documentation available, the main environmental concerns and risks are related to climate change, led by regulatory changes towards the mitigation of GHG emissions, control of pollution and improvement of energy efficiency within the energy sector, as shown in the European Investment Bank\(^{13}\) and EY reports.\(^{14}\) In fact, an EY study\(^{14}\) puts energy and environmental regulation as top compliance-related risk for the power & utilities industry. Furthermore, Protiviti\(^{18}\) reveals that increasing regulatory and consumers pressures make companies within power & utilities sector increasingly exposed to such risks. However, according to S&P\(^{15}\), the power & utilities sector is subject to different environmental risks also due to its heterogenous businesses: as an example, nuclear power production has risks related to waste management but not GHG emissions. The importance of risks associated with climate change is confirmed by one response (out of two respondents) to the survey together with other environmental risk factors such as biodiversity loss and ecosystem collapse.

**Social** | According to the above-mentioned study conducted by EY\(^{14}\) on "top five compliance risks facing P&U organisations", at the second position there is health and safety of workers, citing an American statistics of last 2014 about fatal work injuries within the sector, that were 5 times higher than the average in USA. The EY study also highlights that the long-term trend has decreased in time, despite data. Protiviti analysis already mentioned\(^{18}\) highlight also the importance of "succession and talent acquisition/retention challenges" in the industry, that are still a priority. S&P\(^{15}\) reports also that the sector "has a considerable influence on local communities".

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\(^{13}\) European Investment Bank (2019), ‘EU Bank launches ambitious new climate strategy and Energy Lending Policy’.


### Areas of analysis

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<tr>
<th>Detail</th>
<th>Main findings and supporting evidence</th>
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<tr>
<td></td>
<td>All risks mentioned above are confirmed by the responses to the survey: employees’ health &amp; safety (2 responses out of 2), impacts related to the local communities in which the company operates (1 response out of 2), retention/attraction of talents (1 response out of 2).</td>
</tr>
<tr>
<td>Economic</td>
<td>The sectorial documents available have a strong focus on economic risks to which the sector is subject due to regulatory shifts and lack of adaptation to new environment. In particular, a PwC paper on TCFD recommendations states that &quot;with an improved understanding of how your company may be financially impacted by climate change, you can start to manage the risks and capture the opportunities. This often goes beyond the more qualitative analyses of risk currently asked of by existing climate disclosure initiatives&quot;. Protiviti also confirm that there is an &quot;investor momentum shifts toward social responsibility and emission/carbon reduction actions, both of which have broad impacts to the organisation’s operations and internal processes as they look to comply and report&quot;. The EY study above mentioned reports, among the top compliance risks: &quot;tax compliance&quot; and &quot;fraud, waste, abuse and corruption&quot; that could economically affect companies if not fairly managed, as well as the risks related to the &quot;complexity and volume of regulatory requirements&quot; to which the sector is subjected. Finally, literary review highlights how economic risks to which power &amp; utilities companies are subject could represent an opportunity to change traditional business models and gain competitivity, in a continuously evolving regulatory environment.</td>
</tr>
</tbody>
</table>

### Alignment of risks identified with relevant sustainability topics

|        | The sectorial documents available agree on the fact that further steps must be done to take climate change and the path towards decarbonisation. In particular, S&P always highlight differences among environmental and social risks to which the sector is subject, depending on the source of power generated (e.g. coal, non-coal, gas, nuclear, renewable). The GHG reduction is definitely a relevant topic within the sector, "but despite being a global focus, the pace of carbon reduction is not uniform throughout the sector and we expect that, by the next decade, coal generation will still represent over 25% of total generation". Protiviti reports the issue related to the lack of alignment within the sector, stating that "organisations within the industry group are being forced to review their risk environment from a broader perspective". |

### Methodology used to identify and prioritise risks

|        | Engagement and involvement of corporate functions and collaboration between sustainability and risk functions |
|        | Integration of sustainability and ESG risks in the ERM model |
|        | Boundaries of the process for the identification of risks (supply chain, life cycle of the project) |
|        | The information gathered from sectorial documents and survey is not sufficient to draw conclusions on the subject. |
### Areas of analysis | Detail | Main findings and supporting evidence
--- | --- | ---
**Most critical issues that the companies encounter in the process of integrating environmental and social-related risks and impacts into the Enterprise Risk Management and into corporate strategies**

Among the two survey respondents, only one company declares difficulties encountered in the integration of non-financial risks within the ERM, among them: different time horizon between ESG-related risks and other business risks, difficulties in quantitative assessment of the ESG-related risks, difficulties in the identification of ESG-related risks through the value chain. The information gathered from sectorial documents and survey, however, is not sufficient to draw conclusions on the subject.

#### Evaluation and estimation of the potential impacts linked to the identified risks

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<tr>
<th></th>
<th>KPIs used to assess environmental risks</th>
<th>KPIs used to assess social risks</th>
<th>KPIs used to assess economic risks</th>
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<tbody>
<tr>
<td>Level of involvement of the board in the identification and evaluation of the risks</td>
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</table>

The information gathered is not sufficient to draw conclusions on the subject.

#### Disclosure of risk related information and sustainability strategy

| Actual disclosure and type of document used | Both of the Survey respondents communicate their impacts on Non-Financial disclosures. Moreover, they disclose such topics in Financial Report and/or Sustainability Report (voluntary). Just one respondent follows the Global Reporting Initiative (GRI) as reporting standards. The information gathered from the survey, however, is not sufficient to draw conclusions on the subject. |

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### 3.5 Oil and gas

#### Areas of analysis | Detail | Main findings and supporting evidence
--- | --- | ---
**Sustainability risks under consideration** | Environmental | The Oil & Gas industry is highly subject to climate change-related risks, as reported by different sectorial documents available, the ESG Industry Report Card and the KPMG Survey, by IPD. In particular, KPMG considers the sector, among others, to "have a higher than average rate of acknowledging climate risk". Furthermore, S&P reports that "as fossil fuel producers, oil and gas companies are among the most exposed to the energy transition. This could weigh on long-term average oil prices and

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### Areas of analysis

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<th>Detail</th>
<th>Main findings and supporting evidence</th>
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<tbody>
<tr>
<td><strong>Social</strong></td>
<td>Protiviti(^{18}) confirms that, more in general, energy sector is highly subject to external pressures coming from stakeholders. Also, the two interviews with NGOs stress on such issues, highlighting that the raising sea level, increased intensification of storms, how the melting of permafrost or change in land structure geometries is physically threatening oil and gas infrastructures. Finally, S&amp;P(^{19}) indicates &quot;pollution, safety and community impacts&quot; among the most critical issues to tackle within the sector, including &quot;risks related to the use of chemicals (in fracking) as well as high impact, low probability events such as severe oil spills and refinery accidents. Related sectors that have a higher exposure to such risks are oil sands, shale, and offshore&quot;.</td>
</tr>
<tr>
<td><strong>Economic</strong></td>
<td>The Oil &amp; Gas industry is highly subject to economic risks as consequence of regulatory and compliance issues, as reported by different sectorial documents available and a business association interviewed. In particular, according to Fuels Europe Vision 2050,(^{21}) &quot;(...) there is a risk that manufacturing activities could be offshored to countries with lower climate ambitions, which would result in an increase in product imports and lower security of supply&quot;, while PwC(^{22}) reports that with an improved understanding on how companies &quot;may be financially impacted by climate change&quot;, they could &quot;start to manage the risks and capture the opportunities&quot;, revealing that actually main risks already mentioned might economically affect oil &amp; gas industry. Bloomberg(^{23}) stress on this scenario, agreeing on the fact that, for example, &quot;taxes and restrictions aimed at encouraging a shift to electric cars and away from coal-fired power plants could hammer sales of fossil fuels. A drop-in consumption of coal, oil, and gas would have knock-on effects felt throughout the global economy, potentially</td>
</tr>
</tbody>
</table>


\(^{22}\) PwC (2017), ‘The FSB Task Force on Climate-related Financial Disclosures. What do its recommendations mean for the energy sector?’.

\(^{23}\) Carr, M. (2019), ‘Putting a price on the risk of climate change. Efforts to slow global warming threaten to turn energy investments into stranded assets’, Bloomberg, web page, available at [link](#).
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<tr>
<th>Areas of analysis</th>
<th>Detail</th>
<th>Main findings and supporting evidence</th>
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</thead>
<tbody>
<tr>
<td>Alignment of risks identified with relevant sustainability topics</td>
<td>spurring a decline in the value of companies sitting on stranded assets”, as S&amp;P\textsuperscript{16} also highlights. No information has been gathered from interviews on this topic.</td>
<td></td>
</tr>
<tr>
<td>Methodology used to identify and prioritise risks</td>
<td>Engagement and involvement of corporate functions and collaboration between sustainability and risk functions</td>
<td>In general terms, there seems to be a good correlation between the risks identified and the sustainability topics/impacts of the sector (as confirmed by the business association interviewed), especially as concerns climate change, relationships with local communities and human rights. However, according to Bloomberg\textsuperscript{23}, risks within the oil &amp; gas industry are not well priced and so underestimated. Interviews with NGOs are in line with this finding, affirming that companies are still playing a “waiting game” for policy makers to set clear regulatory framework to come forward before they really manage their risks, thus highlighting Policy failures.</td>
</tr>
<tr>
<td>Integration of sustainability and ESG risks in the ERM model</td>
<td>The information gathered is not sufficient to draw relevant and significant conclusions on the subject.</td>
<td></td>
</tr>
<tr>
<td>Boundaries of the process for the identification of risks (supply chain, life cycle of the project)</td>
<td>The information gathered is not sufficient to draw relevant and significant conclusions on the subject.</td>
<td></td>
</tr>
<tr>
<td>Most critical issues that the companies encounter in the process of integrating environmental and social-related risks and impacts into the Enterprise Risk Management and into corporate strategies</td>
<td>According to Bloomberg\textsuperscript{23}, “the more we talk about the long term, the more we continue doing exactly what we’ve been doing (i.e. business as usual). (…) A delay would mean more money spent on projects that turn out to be unnecessary and meeting the goal would require more urgent and more costly measures—and not only for energy companies”, signifying that a long-term perspective is essential in order not to lose investments and maintain competitiveness in the sector. This perspective is the main issue encountered. However, findings from sectorial documents cannot be intended as exhaustive to extend assumptions on the entire sector.</td>
<td></td>
</tr>
<tr>
<td>Evaluation and estimation of the potential impacts</td>
<td>KPIs used to assess environmental risks</td>
<td>According to PwC\textsuperscript{22}, the scenario analysis may help companies to assess risks within the sector as “based on the scenarios developed energy sector companies’ income statements may need to consider carbon-pricing assumptions, including any internal carbon price applied, and the potential impacts of climate-related risks and</td>
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<tr>
<td>KPIs used to assess social risks</td>
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<td>KPIs used to assess economic risks</td>
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</table>
### 3.6 Pharmaceutical

<table>
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<tr>
<th>Areas of analysis</th>
<th>Detail</th>
<th>Main findings and supporting evidence</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Sustainability risks under consideration</strong></td>
<td>Environmental</td>
<td>Based on the document analysis carried out, the pharmaceutical sector seems to be, at present, more focused and developed in the identification of sustainability impacts, which are well known, than it is in the identification of risks. According to the two companies that took part in the survey, the main environmental risks are related to non-compliances with normative requirements and the potential...</td>
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</table>
## Study on directors’ duties and sustainable corporate governance

### Areas of analysis

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<th>Detail</th>
<th>Main findings and supporting evidence</th>
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<tr>
<td></td>
<td>risks related to pollutant emissions. The sectorial document analysis confirmed that extreme weather or supply disruptions can affect some manufacturers, but to date this has rarely caused credit deterioration within the pharmaceutical sector. The sectoral study highlighted that, in developed countries, aging populations put cost pressure on health care systems: improving health outcomes while raising the cost effectiveness of therapies are increasingly becoming twin goals for health care companies. On the other hand, according to the two companies that took part in the survey, the social risks that are felt as most relevant are the non-compliances with normative requirements and product safety.</td>
</tr>
</tbody>
</table>

### Social

- Alignment of risks identified with relevant sustainability topics
  - Given the sectorial lack in the identification of ESG risks as stated above, it is not possible to draw conclusions on the alignment between risks and impacts/topics of the sector.

### Economic

- Alignment of risks identified with relevant sustainability topics
  - Given the sectorial lack in the identification of ESG risks as stated above, it is not possible to draw conclusions on the alignment between risks and impacts/topics of the sector.

### Methodology used to identify and prioritise risks

<table>
<thead>
<tr>
<th>Methodology</th>
<th>Description</th>
<th>Notes</th>
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<tbody>
<tr>
<td>Engagement and involvement of corporate functions and collaboration between sustainability and risk functions</td>
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<td></td>
</tr>
<tr>
<td>Integration of sustainability and ESG risks in the ERM model</td>
<td>The information gathered is not sufficient to draw conclusions on the subject.</td>
<td></td>
</tr>
<tr>
<td>Boundaries of the process for the identification of risks (supply chain, life cycle of the project)</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>Most critical issues that the companies encounter in the process of integrating environmental and social-related risks and impacts into the Enterprise Risk Management and into corporate strategies</td>
<td>The information gathered is not sufficient to draw conclusions on the subject. According to one company that took part in the survey, the main difficulty of the integration of ESG-related risks in the Enterprise Risk Management is their quantitative assessment.</td>
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</tbody>
</table>

### Evaluation and estimation of the potential impacts linked to the identified risks

| KPIs used to assess environmental risks | - |
| KPIs used to assess social risks | - |
| KPIs used to assess economic risks | - |

### Level of involvement of the board in the identification and evaluation

| Involvement in the identification and evaluation | - |

---

### Areas of analysis | Detail | Main findings and supporting evidence
--- | --- | ---
**evaluation of the risks** |  |  |
**Disclosure of risk related information and sustainability strategy** | Actual disclosure and type of document used | The information gathered is not sufficient to draw conclusions on the subject. |

#### 3.7 Food

<table>
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<tr>
<th>Areas of analysis</th>
<th>Detail</th>
<th>Main findings and supporting evidence</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Sustainability risks under consideration</strong></td>
<td>Environmental</td>
<td>The main environmental risk is climate change, that has a big impact on food production and resource scarcity and degradation.25</td>
</tr>
<tr>
<td>Social</td>
<td>In its 2016 Strategic Research and Innovation Agenda, the European Technology Platform (ETP) 'Food for Life'26 has identified four critical global challenges for which the European food sector is required to develop solutions: demographic changes, consumer engagement, consumer behaviour and perception of food. Based on the responses of the stakeholders involved with the online survey (2 responses, 1 company and 1 business organisation), no relevant conclusions could be drawn. There is a need to produce more with less (improve resource efficiency), as stressed by a representative of a sectoral business organisation (interview), as the global population grows and the demand for food increases.</td>
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<tr>
<td>Economic</td>
<td>The food sector is aware of the economic risks related to a lack of adaptation to a changing context (e.g. food waste). Specifically, as described in Ambitions for 2025 Priorities and policy recommendations,27 economic risks might be related to:</td>
<td>• Resource scarcity and more volatile prices of raw materials; • Increased pressure on prices from retailers has an impact on investment in the sector; • Regulatory hurdles, red tape and skill gaps do not encourage R&amp;D, innovation or entrepreneurial behaviour; • Trust and reputation of the industry are under increased public scrutiny.</td>
</tr>
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25 Joint Food Wastage Declaration, 'Competitive EU Food and Drink Industry for Growth and Job'; Results from the survey - response from a business association.  
### Study on directors’ duties and sustainable corporate governance

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<tbody>
<tr>
<td><strong>Main findings and supporting evidence</strong></td>
<td>According to the Economic Cost of Climate Change in Europe(^28) the coverage of economic analysis and policies with regards to Climate Change of European and national studies is good, showing a general good equilibrium. The study also shows that there are emerging policy analysis on adaptation and economics arising within the food sector.</td>
<td></td>
</tr>
</tbody>
</table>

| Alignment of risks identified with relevant sustainability topics | The information gathered is not sufficient to draw conclusions on the subject. Anyway, according to the results of the survey (1 response by a company out of 2)\(^25\) and to the NGO interviewed, it appears that there is not complete alignment between risks identified and sustainability impacts and that many impacts are still externalised and ignored by the companies. |

| Alignment of risks identified with relevant sustainability topics | The information gathered is not sufficient to draw conclusions on the subject. Anyway, according to the results of the survey (1 response by a company out of 2)\(^25\) and to the NGO interviewed, it appears that there is not complete alignment between risks identified and sustainability impacts and that many impacts are still externalised and ignored by the companies. |

<table>
<thead>
<tr>
<th><strong>Methodology used to identify and prioritise risks</strong></th>
<th>Engagement and involvement of corporate functions and collaboration between sustainability and risk functions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Details</td>
<td>Integration of sustainability and ESG risks in the ERM model</td>
</tr>
<tr>
<td>-</td>
<td>Results from the survey, the interviews and the document analysis show a mixed and unclear scenario, thus it is not possible to draw affordable conclusions on the subject. What is clear is that there is an increasing attention in the identification of risks, but more integration and management measures are needed.</td>
</tr>
<tr>
<td>-</td>
<td>The sector recognises the importance of the entire value chain while addressing risks (Joint Food Wastage Declaration(^25), EnviFoodProtocol(^29), OECD-FAO Guidance for Responsible Agricultural Supply Chains(^30)) and all interactions and stakeholders along the food chain, including consumers, are considered. This approach is also suggested by the representative of the sectorial business organisation interviewed.</td>
</tr>
<tr>
<td>-</td>
<td>The information gathered is not sufficient to draw conclusions on the subject.</td>
</tr>
</tbody>
</table>

| **Boundary of the process for the identification of risks (supply chain, lifecycle of the project)** | The information gathered is not sufficient to draw conclusions on the subject. |

<table>
<thead>
<tr>
<th><strong>Evaluation and estimation of the potential impacts linked to the identified risks</strong></th>
<th>KPIs used to assess environmental risks</th>
</tr>
</thead>
<tbody>
<tr>
<td>Details</td>
<td>KPIs used to assess social risks</td>
</tr>
<tr>
<td>-</td>
<td>KPIs used to assess economic risks</td>
</tr>
<tr>
<td>-</td>
<td>There is no alignment on KPIs to be used to measure ESG risks within the sector, according to a business organisation involved through interview. The information gathered is not enough to draw further conclusions on the subject.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>Level of involvement of the</strong></th>
<th>Involvement in the identification</th>
</tr>
</thead>
<tbody>
<tr>
<td>Details</td>
<td>Involvement in the evaluation</td>
</tr>
<tr>
<td>-</td>
<td>Even though conclusions can hardly be drawn on this aspect, both a company involved through the online survey and an NGO interviewed agreed that companies’ boards are</td>
</tr>
</tbody>
</table>

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\(^28\) *The Economic Cost of Climate Change in Europe, Synthesis Report on State of Knowledge and Key Research Gaps*.

\(^29\) ENVIFOOD Protocol, available at [link](#).

\(^30\) OECD-FAO Guidance for Responsible Agricultural Supply Chains.
Areas of analysis | Detail | Main findings and supporting evidence
--- | --- | ---
board in the identification and evaluation of the risks | not involved in the identification and evaluation of risks but still defines sustainability priorities and ensure that sustainability performance is communicated at annual meetings to investors. In some cases, the companies' CSR team is dedicated to this task, but is not given a mandate by the Board, thus still lacking integration within the business model and ERM. 
Disclosure of risk related information and sustainability strategy | Actual disclosure and type of document used | According to a business organisation which has been interviewed and a company involved in the survey, the companies that are more sustainability-driven include risks and impacts information within their annual financial reporting.

3.8 Car manufacture

Areas of analysis | Detail | Main findings and supporting evidence
--- | --- | ---
Sustainability risks under consideration | Environmental | 'Based on the documentary analysis, the main environmental risks for the sector are:
- Risk related to supply chain, with a focus on raw materials. Drive Sustainability, in collaboration with the Responsible Minerals Initiative (RMI), commissioned a risk assessment study from The Dragon Fly Initiative in 2018.\(^{31}\)
- Risk related to a non-transition to zero/low emissions mobility. Even if in this change process it's possible to incur in risk related to the cost of emission-reducing technologies and the cost of alternative fuel vehicles,\(^{32}\) the sale of zero/low emissions vehicles\(^{33}\) are increasing and there are incentives and tax benefits offered by in numerous EU countries,\(^{34}\) thus generating also opportunities for the player in the sector.
- Risk related to Climate Change. According to TPI analysis\(^{35}\) of the total auto manufacturers analysed, about 80% recognises Climate change as risk/opportunity and have a process to manage climate risks and less of 40% undertakes climate scenario planning.

Social | Based on the documentary analysis, the main social risks for the sector are:
- Risk related to supply chain regarding social and human rights aspect. Inside the risk

\(^{32}\) PRI, ‘Shifting Perceptions : Esg, Credit Risk And Ratings’, Part 2 Exploring The Disconnects.
\(^{34}\) ACEA, ‘Electric Vehicles: Tax Benefits & Incentives In The EU’.
\(^{35}\) TPI (2019), ‘Management Quality and Carbon Performance of Transport Companies’.
### Areas of analysis

<table>
<thead>
<tr>
<th>Detail</th>
<th>Main findings and supporting evidence</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>assessment study on raw materials made by Drive Sustainability and the Responsible Minerals Initiative (RMI), social and human rights aspects are considered (i.e. Child labour and forced labour; Incidences of conflict with Indigenous Peoples; Artisanal and small-scale mining-ASM). Other social risks are, for example, operational costs to prevent or to deal with health and safety accidents, changing consumer preference (digitalisation/share mobility/ autonomous driving and cost of retraining workforce).</td>
</tr>
<tr>
<td></td>
<td>Economic</td>
</tr>
<tr>
<td></td>
<td>Based on the documentary analysis, the main economic risk (which is overlapped, by nature, to environmental risks) for the sector is: -Risk related to a non-transition to zero/low emissions mobility. Even if in this change process it’s possible to incur in risk related to the cost of emission-reducing technologies and the cost of alternative fuel vehicles, the sale of zero/low emissions vehicles are increasing and there are incentives and tax benefits offered by in numerous EU countries, thus generating also opportunities for the player in the sector. Other economic and governance risks are, for example, regulatory/legal framework litigation risks and size and diversification.</td>
</tr>
<tr>
<td></td>
<td>Alignment of risks identified with relevant sustainability topics</td>
</tr>
<tr>
<td></td>
<td>According to the documents available and the analysis carried out, there is a strong correlation between the main environmental impacts and topics (related to emissions and climate change and to use and sourcing of raw materials) and the corresponding risks. A possible cause of that is the constant exposure of the sector to stakeholders and final consumers scrutiny, as cars and trucks are nowadays considered to be one of the main GHG and pollutants emitters. This constant exposure could have led the companies to the need of considering ESG risks in advance with respect to other sector.</td>
</tr>
<tr>
<td>Methodology used to identify and prioritise risks</td>
<td>Engagement and involvement of corporate functions and collaboration between sustainability and risk functions Integration of sustainability and ESG risks in the ERM model</td>
</tr>
<tr>
<td></td>
<td>The information gathered is not sufficient to elaborate a judgement. Based on documents publicly available, it is not possible to draw general and affordable conclusions on the topic. However, in 2019 Drive Sustainability planned to develop a common view on risk assessment and auditing, further developing and strengthening standardised Compliance Process. In addition, Drive Sustainability and the Responsible Minerals Initiative (RMI), commissioned a risk assessment study from The Dragon Fly Initiative in 2018. The result of this analysis has been published in the Material Change report, that lists the 37 raw materials commonly used in the automotive and electronic industry.</td>
</tr>
</tbody>
</table>

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<table>
<thead>
<tr>
<th>Areas of analysis</th>
<th>Detail</th>
<th>Main findings and supporting evidence</th>
</tr>
</thead>
<tbody>
<tr>
<td>Boundaries of the process for the identification of risks (supply chain, life cycle of the project)</td>
<td>The risks identification carried out by Drive Sustainability and RMI is related to the automotive sector supply chain.</td>
<td></td>
</tr>
<tr>
<td>Timeline to evaluate the likelihood and impact of the risks identified and link with the timeline used to evaluate financial and business risks</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>Frequency for updating the identification and evaluation of risks</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>Most critical issues that the companies encounter in the process of integrating environmental and social-related risks and impacts into the Enterprise Risk Management and into corporate strategies</td>
<td>The big unknowns are related to future product offerings and their quality, changes in client preferences, increased digitalisation and connectivity, as well as uncertainties related to the regulatory environment. A side effect of these changes is the varying mix of labour input in car production versus that of fixed capital, with ramifications on jobs, changing skillset requirements and costs related to workforce restructuring. All European automobile manufacturers are constantly expanding their portfolios of such vehicles. However, their market penetration remains low and fragmented across the EU. Consumers looking for an alternative to diesel often opt for petrol vehicles, but are not yet making the switch to alternatively-powered vehicles on a large scale. Another point of attention is the inadequate level of the charging and refuelling infrastructures. In addition, two biggest obstacles in setting strategies for responsible sourcing are: 1) access to reliable data and analysis on the environmental and social dimensions of material production; 2) the complexity and lacking transparency upstream.</td>
<td></td>
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<tr>
<td>Evaluation and estimation of the KPIs used to assess environmental risks</td>
<td>The information gathered is not sufficient to elaborate a judgement.</td>
<td></td>
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<tr>
<td>KPIs used to assess social risks</td>
<td></td>
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</tbody>
</table>
### Areas of analysis

<table>
<thead>
<tr>
<th>Detail</th>
<th>Main findings and supporting evidence</th>
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</thead>
<tbody>
<tr>
<td><strong>Potential impacts linked to the identified risks</strong></td>
<td>KPIs used to assess economic risks</td>
</tr>
<tr>
<td>Involvement in the identification</td>
<td>The information gathered is not sufficient to elaborate a judgement.</td>
</tr>
<tr>
<td>Involvement in the evaluation</td>
<td></td>
</tr>
<tr>
<td><strong>Disclosure of risk related information and sustainability strategy</strong></td>
<td>Actual disclosure and type of document used</td>
</tr>
<tr>
<td></td>
<td>The information gathered is not sufficient to elaborate a judgement.</td>
</tr>
</tbody>
</table>

### 3.9 Transport

<table>
<thead>
<tr>
<th>Areas of analysis</th>
<th>Detail</th>
<th>Main findings and supporting evidence</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Sustainability risks under consideration</strong></td>
<td>Environmental</td>
<td>As concerns sustainability risks, the analysis of sectorial documentation <em>ESG Industry Report Card: Transportation Infrastructure</em>37 shows that extreme weather events, which could be one of the consequences of climate change, have the ability to disrupt the transport sector, typically for short timeframes (especially airports and ports). Among other reasons, the exposure to such risk factor is due to the obsolescence of infrastructures, as highlighted also by one representative of a transport business organisation: for instance, rising sea levels deriving from climate change represent a remote but potentially high-impact long-term risk. Moreover, land use can be a risk factor in the case of expansions, extensions and new developments, in relation to regulatory compliance. Transport infrastructure businesses are often in highly populated urban areas: planning and approvals for developments requiring new land or more intensive use of existing land can be more difficult to achieve if government bodies and local communities develop sensibility on their ESG-impacts, according to <em>ESG Industry Report Card: Transportation Infrastructure</em>.37</td>
</tr>
<tr>
<td>Social</td>
<td>The main social risks are related to the increase in the urbanisation rate: this can impact lifestyle, congestion, noise, and air quality. Such aspects are being increasingly highlighted and brought to the attention of media, businesses, investors, governments and regulators, thus turning in a reputational risk for the sector, as highlighted by</td>
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</table>

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### Areas of analysis

<table>
<thead>
<tr>
<th>Main findings and supporting evidence</th>
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<tbody>
<tr>
<td>Sectoral document <em>ESG Industry Report Card: Transportation Infrastructure</em> and by the representative of the transport-NGO involved in the interview. Moreover, as stated by a European sectorial business association and by a KPMG study, personnel scarcity is another social risk that the sector has to focus on, particularly in terms of facing the inability to attract and retain qualified personnel while appropriately managing costs related to employee benefits. Finally, safety management and potential human errors leading to accidents and technical failures are other risks that the sector is going to face (as highlighted in the KPMG study and in the sectoral document <em>ESG Industry Report Card: Transportation Infrastructure</em>).</td>
</tr>
</tbody>
</table>

### Economic

| Economic factors are related to the sector's ability to oversee and manage interactions with governments and communities, considering the public-private partnerships, concession agreements, or status as provider of an essential basic service. According to one representative of the sectoral NGO interviewed, the companies within the sector need to be technologically competitive not to be overcome by companies outside EU and to keep the financial support by the entities that are now starting to require a proactive ESG management to make companies enter in their portfolios. As highlighted by sectorial document airports and road operations are also exposed to customer service levels, since any disruption to these services would trigger potential negative political pressures, exposing them to penalties or even putting at risk their concessions. |

### Methodology used to identify and prioritise risks

| Alignment of risks identified with relevant sustainability topics |
| According to all evidences gathered, there seems to be a good alignment between the risks identified and the sustainability topics and impacts of the sector, primarily in terms of GHG emissions/Climate change and of pollutant emissions/air quality/people health and safety. |

| Engagement and involvement of corporate functions and collaboration between sustainability and risk functions |
| According to the sectoral NGO interviewed, ESG aspects are not incorporated in the high-level decision making and core business model, nor sufficiently integrated in the ERM. This is confirmed by the representative of the sectoral business organisation involved, which highlighted that transport companies move towards sustainability actions in order to comply with the legislation, but those actions aren't still incorporated within the business itself. Evidences gathered are not sufficient to elaborate a more detailed judgement. |

| Integration of sustainability and ESG risks in the ERM model |
| According to the documentation available and to the interviews carried out, risks should be evaluated taking into account the entire supply chain (e.g. risks related to climate change and employment working conditions can't be evaluated considering only internal boundaries). However, based on the documentary analysis and on the BO and NGO interviews (two interviews), the ESG risk assessment seems to be focused on |

---

### Areas of analysis | Detail | Main findings and supporting evidence
--- | --- | ---
**Areas of analysis** | **Detail** | **Main findings and supporting evidence**
--- | --- | ---
Main findings and supporting evidence | the sector itself and it does not include upstream and downstream activities along the value chain; anyway, evidences collected does not allow to elaborate a more detailed judgement. | Most critical issues that the companies encounter in the process of integrating environmental and social-related risks and impacts into the Enterprise Risk Management and into corporate strategies 
According to the documentary review, no specific issues have been identified as main drivers for the lack of integration of ESG risks and impacts in corporate strategies and business risks management (ERM). Anyway, according to the representatives from the sectorial NGO and business organisation interviewed (two interviews), the shift from tyre to rail, which would represent a fundamental step toward a more sustainable business, requires long-term planning, investment and new regulation, as nowadays the regulatory framework represent the main driver for change in this sector. 

| Evaluation and estimation of the potential impacts linked to the identified risks | KPIs used to assess environmental risks | - |
| --- | KPIs used to assess social risks | - |
| Level of involvement of the board in the identification and evaluation of the risks | KPIs used to assess economic risks | - |
| Disclosure of risk related information and sustainability strategy | Involvement in the identification and evaluation | The information gathered is not sufficient to draw conclusions on the subject. According to the sector NGO interviewed, only a few boards have expertise on sustainability issues. |
| | Actual disclosure and type of document used | The information gathered is not sufficient to draw conclusions on the subject. |

#### 3.10 Chemical industry

**Areas of analysis** | **Detail** | **Main findings and supporting evidence**
--- | --- | ---
**Sustainability risks under consideration** | Environmental | Chemical companies face risks related to water use, water scarcity, efficiency, decontamination, and climate impact, as stated by the ESG Industry Report Card: Chemicals and confirmed by the three business organisations and the company that took part in the survey and the representative of one sectorial NGO. Also, chemical companies face environmental risks arising from their exposure to waste, pollution, and toxicity. |

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### Areas of analysis

<table>
<thead>
<tr>
<th>Social</th>
<th>Economic</th>
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<tbody>
<tr>
<td>As stated by the ESG Industry Report Card: Chemicals the key social risks for chemical companies are demographic changes (such as rising populations, urbanisation, and greater economic development), safety management, and the growing influence of consumer behavior. In particular, social awareness about chemical products (e.g. toward plastics), particularly with regard to health and environmental issues, is likely to further increase: for example, the willingness of some consumers to pay a premium for foods produced without chemical preservatives or other substances, could diminish demand for chemical products. Nevertheless, although some of these evolving trends do not meaningfully affect demand, social perception of chemical products and consumer preferences could pose important long-term risks to companies. The responses to the survey highlighted different categories of risk: retention/attraction of talents (3 out of 4 responses), employees’ health &amp; safety (2 out of 4 responses), impacts related to the local communities in which the company operates (2 out of 4 responses). Thus, the scenario on social risks associated with the chemical sector seems to be quite complex and differentiated.</td>
<td></td>
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<tr>
<td>The global trend toward more stringent environmental regulation heightens the economical and reputational risks that all chemical companies face, as suggested by a representative of a sectoral NGO involved. Many chemical products, raw materials, and by-products or effluents are polluting and toxic, and, as a result, several chemical companies face ongoing liabilities or litigation; in addition to that, chemical companies face risks from the fallout of accidents in the manufacture or transport of certain hazardous chemicals. Such low-probability but potentially high-impact accidents can result in financial claims, loss of operational licenses, or damage to public perception of chemical companies, as confirmed in the ESG Industry Report Card.</td>
<td></td>
</tr>
<tr>
<td>Alignment of risks identified with relevant sustainability topics</td>
<td>Even if no specific evidences could be gathered on this topic from the documentary analysis and the interviews, there seems to be a good alignment between ESG risks identified and sustainability topics / impacts, especially in terms of environmental aspects (pollution, chemicals, climate change).</td>
</tr>
</tbody>
</table>

### Methodology used to identify and prioritise risks

<table>
<thead>
<tr>
<th>Engagement and involvement of corporate functions and collaboration between sustainability and risk functions</th>
<th>Integration of sustainability and ESG risks in the ERM model</th>
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</thead>
<tbody>
<tr>
<td>-</td>
<td>Although no sufficient information has been collected to draw conclusion on this topic, a business organisation and a chemical company confirmed that the process for the evaluation of ESG-related risks is included within the Enterprise Risk Management (results from the on-line survey).</td>
</tr>
<tr>
<td>Boundaries of the process for the identification of risks (supply chain, life cycle of the project)</td>
<td>-</td>
</tr>
<tr>
<td>Most critical issues that the companies encounter in the process of integrating</td>
<td>According to one company involved, different time horizon between ESG-related risks and other business risks is the main critical issue for the integration of the two.</td>
</tr>
<tr>
<td>Areas of analysis</td>
<td>Detail</td>
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<tr>
<td>Evaluation and estimation of the potential impacts linked to the identified risks</td>
<td>KPIs used to assess environmental risks</td>
</tr>
<tr>
<td></td>
<td>KPIs used to assess social risks</td>
</tr>
<tr>
<td></td>
<td>KPIs used to assess economic risks</td>
</tr>
</tbody>
</table>
| Level of involvement of the board in the identification and evaluation of the risks | Involvement in the identification and evaluation | Even though it is not possible to make conclusion on the subject based on the information collected, two business organisation and one company (from the on-line survey) stated that the companies’ boards are involved in the identification of sustainability risks and impacts, and the main activities they are involved in are:  
- Defining sustainability priorities  
- Ensuring that the company’s sustainability strategy and performance are communicated at annual meetings and to investors  
- Overseeing the implementation of the strategy and ensure that key targets are being met  
- Setting measurable sustainability targets |
| Disclosure of risk related information and sustainability strategy | Actual disclosure and type of document used | - |
### 4 Analysis of Gaps in the Estimation of Sustainability Impacts by Listed Companies

#### 4.1 Garment

<table>
<thead>
<tr>
<th>Areas of analysis</th>
<th>Detail</th>
<th>Main findings and supporting evidence</th>
</tr>
</thead>
<tbody>
<tr>
<td>Impacts under consideration</td>
<td>Identification of impacts</td>
<td>Based on all evidences gathered (survey - 2 responses by sectorial companies - interviews - one NGO, two business organisation and one company - and documentary review), the most relevant sustainability impacts of the garment sector are: - use and disposal of resources and materials, which implies also the need to consider the implications with an extended view along the whole value chain; - climate change (emissions deriving from companies' activities and processes but also from the production of raw materials); - use of hazardous materials along the value chain and emissions into air and water, which can have an impact on biodiversity and ecosystems as well; - labor conditions and respects of human rights along the value chain, including health and safety of workers, non-discrimination, wages.</td>
</tr>
<tr>
<td>Management of impacts and related gaps</td>
<td></td>
<td>Based on the survey (2 respondents) and literary review, the impacts are mainly managed through due diligence processes, audits and specific contracts requirements, even if the management of impacts highly depend on Companies' approach and maturity. In this scenario, a risk for the companies in this sector derives from the inadequacy of audit and due diligence processes put in place(^3) as &quot;The quality and accuracy of third-party monitoring reports depend largely on the methodology used in the assessments, the independence of the assessors from the factory and the apparel company, and the weight given to testimonies from workers and other interested parties. These tools are not sufficient in and of themselves to detect all instances of abuse, unauthorised subcontracting, and other problems.&quot; As a best practice, Kering developed EP&amp;L (Environmental Profit and Loss), a tool which can be used to evaluate and quantify environmental impacts of the Company's activities. The results of such evaluation are annually published by the Company.</td>
</tr>
</tbody>
</table>

#### Evaluation and estimation of the potential impacts linked to the identified impacts

| KPIs used to assess environmental impacts               | The main issue related to the identification of common KPIs is related to the lack of alignment among EU/national institutions and sectorial practices; therefore the scenario is different from company to company (source: interviews with one NGO and one business organisation). As stated above, there are some best practices, such as Kering EP&L tool, and there are some evolving metrics which will be defined at international level during next months/years which will be useful for the sector (e.g. the new GRI - Global Reporting Initiative - indicators 306 related to waste and circular economy). |
|--------------------------------------------------------|---------------------------------------------|--------------------------------------------------------------------------------------------------------|
| KPIs used to assess social impacts                      |                                             |                                                                                                       |
| KPIs used to assess economic impacts                    |                                             | No specific KPIs to assess economic impact emerged from the study.                                      |

#### Level of involvement of the Board

<table>
<thead>
<tr>
<th>Involvement in the identification and evaluation</th>
<th>Based on the survey (2 respondents) and the interviews, at high level, the Board is typically involved in the process of identification of ESG-related risks and impacts,</th>
</tr>
</thead>
</table>
Areas of analysis | Detail | Main findings and supporting evidence
---|---|---
**board in the identification and evaluation of the risks** | supervising lower dedicated functions. However, it does not mean that Board members are sustainability experts or have sustainability specific competencies. In some cases, the regulation requires the Boards to take responsibility of some sustainability-related topics disclosures (e.g. in UK, a Board member is legally responsible for the modern Slavery Act of its Company). There are already best cases in which the head of Sustainability is actively part of the executive committee and there is sustainability-related remuneration on executives.

**Disclosure of impacts related information and sustainability strategy** | Actual disclosure and type of document used | Normally, Financial annual reports and Non-Financial Declarations are official documents in which Companies disclose about sustainability risks and impacts, together with other documents, as CDP Guidelines, GRI Standards and TCFD recommendations which are voluntarily taken into account by garment sector Companies. Those kinds of documents emerged also from the online survey (2 respondents). As stated above and based on documentary review and interviews, the sector is highly exposed to requests for transparent and constant disclosure, considering also the close relationship with final consumers.

Existence of a sustainability strategy | Even if evidences gathered are not sufficient to draw relevant and representative conclusions, the attention of the sector to the definition of sustainability priorities and strategy seems to be increasing.

Alignment of targets with EU policy priorities | - |

Consideration of sustainability risks and impacts when defining sustainability targets | - |

### 4.2 Telecommunications

Areas of analysis | Detail | Main findings and supporting evidence
---|---|---
**Impacts under consideration** | Identification of impacts | The telecom sector uses a relevant amount of energy to power its communication networks, data centers and operations (such as truck rolls, IT systems, call centers, points of distribution, and IT systems). According to the respondents of the survey, the only impact on environment is climate change, while the main impacts are on social aspects, such as human rights, corruption and discrimination.

Management of impacts and related gaps | According to both the respondents to the survey (one business organisation and one company) the most significant measures taken by companies to identify and mitigate sustainability risks and impacts are:
- Audits
- Risk management processes.
## Areas of analysis

<table>
<thead>
<tr>
<th>Description</th>
<th>Detail</th>
<th>Main findings and supporting evidence</th>
</tr>
</thead>
<tbody>
<tr>
<td>Main findings and supporting evidence</td>
<td>No other evidence on this topic has been collected, thus not allowing us to draw conclusions. Anyway, it is worth to notice that some international and cross-companies initiatives are in place to manage audits and controls over the supply chain. An example is the JAC - Joint Audit Cooperation, which is a “is an association of telecom operators aiming to verify, assess and develop the Corporate Social Responsibility (CSR) implementation across the manufacturing centers of important multinational suppliers of the Information Communication Technology (ICT) industry.” The process is a coordinated on-site audit and development program in the area of Corporate Social Responsibility (CSR), in which each member company has the responsibility, acting on behalf of the others, to lead a complete audit process to a number of suppliers.</td>
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</tr>
<tr>
<td>Evaluation and estimation of the potential impacts linked to the identified impacts</td>
<td>KPIs used to assess environmental impacts</td>
<td>-</td>
</tr>
<tr>
<td></td>
<td>KPIs used to assess social impacts</td>
<td>-</td>
</tr>
<tr>
<td></td>
<td>KPIs used to assess economic impacts</td>
<td>-</td>
</tr>
<tr>
<td>Level of involvement of the board in the identification and evaluation of the risks</td>
<td>Involvement in the identification and evaluation</td>
<td>According to both the stakeholders involved through the online survey (one business organisation and one company), the companies' boards are involved mainly in the following activities: Define sustainability priorities. Ensure that the company’s sustainability strategy and performance are communicated at annual meetings and to investors. Oversee the implementation of the strategy and ensure that key targets are being met. Set measurable sustainability targets. No other evidence on this topic has been collected, thus not allowing us to draw general and affordable conclusions.</td>
</tr>
<tr>
<td>Disclosure of impacts related information and sustainability strategy</td>
<td>Actual disclosure and type of document used</td>
<td>As per the European Directive 95/2014, some companies are now obliged to report their impacts within the Non-Financial Declaration. Nevertheless, no specific information emerged from the documentary review or the online survey.</td>
</tr>
<tr>
<td></td>
<td>Existence of a sustainability strategy</td>
<td>The Corporate Responsibility Charter embodies the European Telecommunications Network Operator’s Association’s commitment to sustainable development. This commitment is confirmed by the two stakeholders responding to the survey. According to Sustainability in Global Telecommunications Industry there are several initiatives being undertaken at different levels such as: leading companies searching for green options, governments encouraging emissions-free technologies, and much research being carried out on sustainability. Nevertheless, as affirmed by the ESG Industry Report Card:6 Telecoms the individual risk factors, associated time scales, and mitigating factors vary by company.</td>
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</table>
### Study on directors’ duties and sustainable corporate governance

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<th>Areas of analysis</th>
<th>Detail</th>
<th>Main findings and supporting evidence</th>
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<tr>
<td>Alignment of targets with EU policy priorities</td>
<td>Both the respondent to the survey stated the existence of a sustainability strategy. While both respondents to the survey assured compliance of telecom companies’ strategies to the SDGs, no specific information on this aspect emerged from the documentary review. Thus, no general and affordable conclusion can be drawn.</td>
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<tr>
<td>Consideration of sustainability risks and impacts when defining sustainability targets</td>
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### 4.3 Construction

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<tr>
<th>Areas of analysis</th>
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<th>Main findings and supporting evidence</th>
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<tbody>
<tr>
<td>Impacts under consideration</td>
<td>Identification of impacts</td>
<td>Based on the available sectorial documentation, the main environmental impacts identified by the construction sector are: &quot;energy and resource efficiency, climate change, research and innovation in construction, indoor air quality and impacts on human health, dangerous substances&quot;. Furthermore, the Build Upon Organisation states that &quot;The buildings sector is responsible for about 36% of greenhouse gas emissions and 40% of energy consumption in Europe and 97% of the existing building stock is inefficient&quot;. Such identified environmental impacts are coherent with the relevant topics identified by the EIC (European International Contractors) Business Organisation within its 2019 Corporate Responsibility Report and in the GRI G4 Sector Specific Disclosures for Construction and Real Estate Sector, which highlights also the relevance of Land Degradation, Contamination and Remediation.</td>
</tr>
</tbody>
</table>
| | Management of impacts and related gaps | Based on the available sectorial documentation, the main social impacts identified by the construction sector are: "labour law, health & safety, skills and young people". Such identified social impacts are as well coherent with the relevant topics identified by EIC and the GRI G4 Sector Specific Disclosures just mentioned. The sectorial documentation available and analysed, reveals that there are some trade-offs to address when managing typical impacts of the construction sector, mainly related to the non-profitability of sustainable interventions, e.g. renovating existing ...

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40 Build Upon2, ‘Building renovation in the Clean Energy Package: implications at local, national and EU levels’.
42 GRI G4 Sector Specific Disclosures, ‘Construction and Real Estate Sector Disclosures’.
### Areas of analysis

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<td>buildings might be extremely costing comparing with demolition - in contrast with circular economy principles. However, FIEC states that &quot;Building Information Models (BIM) will facilitate design for deconstruction, enabling not only the logging of materials, but also the management of maintenance programmes for the building, including for its technical systems. This kind of information will create smart buildings that are more efficient during their lifecycle and easier to adapt in the case of change of use&quot;, demonstrating that construction sector is developing innovative solutions to mitigate related-environmental impacts connected with the buildings. Finally, S&amp;P affirms that consumers behaviours in response to environmental concerns may support such a perspective in the medium-term.</td>
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<tr>
<td>Evaluation and estimation of the potential impacts linked to the identified impacts</td>
<td>KPIs used to assess environmental impacts</td>
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<tr>
<td></td>
<td>KPIs used to assess social impacts</td>
</tr>
<tr>
<td></td>
<td>KPIs used to assess economic impacts</td>
</tr>
<tr>
<td>Level of involvement of the board in the identification and evaluation of impacts</td>
<td>Involvement in the identification and evaluation</td>
</tr>
<tr>
<td>Disclosure of impacts related information and sustainability strategy</td>
<td>Actual disclosure / type of document used</td>
</tr>
<tr>
<td></td>
<td>Existence of a sustainability strategy</td>
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<td></td>
<td>Alignment of targets with EU policy priorities</td>
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### Areas of analysis

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<tr>
<td>Consideration of sustainability risks and impacts when defining sustainability targets</td>
<td>guidelines applicable for the sector. However, the same Business Organisation reveals how &quot;policymakers tend to have an over-simplified view of energy renovation&quot;, saying that owners want to see tangible returns on investments, not necessarily in the long-term but adopting a short-term perspective.</td>
</tr>
<tr>
<td>The information gathered is not sufficient to elaborate a judgement for the entire construction sector.</td>
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### 4.4 Power and utilities

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<th>Main findings and supporting evidence</th>
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<tr>
<td>Impacts under consideration</td>
<td>Identification of impacts</td>
<td>The analysis of available sectorial documentation shows that the main environmental implications of power &amp; utilities sector are mainly related to climate change and energy and occupational health &amp; safety topics. In particular, the European Technology and Innovation Platform reveals that “heating and cooling (H&amp;C) accounts for about half of the total end energy demand in Europe and they are by far the largest energy consuming sectors”. The GRI G4 Sector Specific Disclosures on Energy Utilities confirms environmental impacts as most relevant, in particular: Availability and Reliability, Demand-Side Management, Research and Development, Plant Decommissioning, System Efficiency, Materials, Water, Biodiversity, Emissions and Effluents and Waste. Among the main social impacts, there are: Occupational Health and Safety, Disaster/ Emergency Planning and Response, Employment, Freedom of Association and Collective Bargaining, Customer Health and Safety, Access and Provision of Information. The two respondents of the survey (companies) broadly confirmed the documentary review, both agreeing to five topics in particular: human rights, bribery and corruption, labor rights, climate change and health &amp; safety.</td>
</tr>
<tr>
<td>Management of impacts and related gaps</td>
<td>Based on main sectorial documents available, the sector still shows room for improvement in the management of impacts. In particular, PwC paper mentioned above still reports the importance for companies to &quot;well position in the low carbon</td>
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45 GRI G4 Sector Specific Disclosures on Energy Utilities.
### Study on directors’ duties and sustainable corporate governance

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<th>Areas of analysis</th>
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<td><strong>Main findings and supporting evidence</strong></td>
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<td>transition. There are strategic, governance, systems and procurement implications to take into account. Protiviti highlights that companies within the sector have always been &quot;lower than other industries to adopt changes&quot;, characterised by &quot;infrastructure of mechanical plants and equipment that have a history of predictable performance and is expensive to change&quot;. In this context, The European Technology and Innovation Platform on Renewable Heating &amp; Cooling highlights the importance of national governments and communities to act quickly to enhance change within short-term, as &quot;the solutions in place by 2030 will deeply influence the sector's outlook by 2050. Considering the high level of decentralisation of H&amp;C solutions, the low level of awareness of the alternatives to fossil fuel technologies, the lack of economies of scale, and the great variety of RHC technologies, fostering the energy shift is a challenging but feasible task&quot;. Cogen Europe (the European Association for the Promotion of Cogeneration) in its 2019 Manifesto, to its part, states that the fundamental driver to achieve Paris climate goals within the sector is Energy Efficiency.</td>
</tr>
<tr>
<td>Evaluation and estimation of the potential impacts linked to the identified impacts</td>
<td>KPIs used to assess environmental impacts</td>
<td>According to the sectorial documentation gathered, specific KPIs on environmental/social impacts have been identified (e.g. Cogen Europe reports the % of energy lost in the conventional electricity generation vs cogeneration; EY reports the fatal work injuries).</td>
</tr>
<tr>
<td></td>
<td>KPIs used to assess social impacts</td>
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<tr>
<td></td>
<td>KPIs used to assess economic impacts</td>
<td>In addition, the GRI G4 Sector Specific Disclosures on Energy Utilities list some economic, environmental and social KPI which are specifically intended to monitor and measure the impacts of the sector. However, the information gathered is not sufficient to draw relevant and significant conclusions at sector level on this subject.</td>
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<tr>
<td>Level of involvement of the board in the identification and evaluation of the risks</td>
<td>Involvement in the identification and evaluation</td>
<td>Based on the two survey respondents, only one affirms the involvement of the board in the identification and evaluation of impacts. The information gathered from the sectorial documents analysis is not sufficient to draw relevant and significant conclusions on the subject.</td>
</tr>
<tr>
<td>Disclosure of impacts related information and sustainability strategy</td>
<td>Actual disclosure and type of document used</td>
<td>Both of the survey, both respondents communicate their impacts on Non-Financial disclosures. Moreover, they disclose such topics in Financial Report and/or Sustainability Report (voluntary). Just one respondent follows the Global Reporting Initiative (GRI) as reporting standards. According to the sectorial documents available, companies should provide information about investment in low-carbon alternatives (e.g., R&amp;D, equipment, products, or services); current internal carbon price or range of prices used in financial planning and</td>
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### Areas of analysis | Detail | Main findings and supporting evidence
---|---|---
Existence of a sustainability strategy | Based on the two survey respondents, only one affirms to have adopted a Sustainability strategy with the definition of targets, highlighting the role of the Board in ensuring that the company’s sustainability strategy and performance are communicated at annual meetings and to investors, overseeing the implementation of the strategy and ensure that key targets are being met and setting measurable sustainability targets. Furthermore, all sectorial documents available agree on the fact that GHG emissions reduction, through different paths, is a priority within the sector, that converges towards decarbonisation goal. In particular, the European Investment Bank \(^{13}\) "will end financing for fossil fuel energy projects from the end of 2021" and the RHC-ETIP \(^{44}\) agrees on the fact that "decarbonisation of the sectors is essential to get climate and energy targets of European Union". As mentioned above, the Business Organisation Cogen Europe \(^{46}\) sets its main priority towards energy efficiency improvements.

Alignment of targets with EU policy priorities | "Utilities need the right incentives to invest in innovation and more energy-efficient solutions. Yet, most regulatory models continue to incentivise capital expansion rather than performance, which is becoming increasingly important to meet sustainability and clean energy goals" (EY - Top five compliance risks facing P&U organisations). Sectorial documentation reveals that regulatory framework has a high impact on the sector, but "the precise nature of future requirements remains unclear as regulators continue to assess both what is needed and what may be possible to deliver to address concerns, and there remains considerable variance in attitudes and approaches from jurisdiction to jurisdiction" \(^{14}\). In this context, organisations promoting renewable sources as the RHC-ETIP \(^{44}\) asks for a more clear and coordinated strategies at European, national and local levels to finally reduce fossil fuels to zero by 2050, stating that “Courageous political decisions are needed immediately to accelerate the ending of fossil fuels”, warning about the complexity and the substantial investments needed to boost such a structural change within the sector, from fossil fuel-based energy to renewable.

Consideration of sustainability risks and impacts when defining sustainability targets | The information gathered is not sufficient to draw relevant and significant conclusions on the subject.
## 4.5 Oil and gas

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<th>Areas of analysis</th>
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<th>Main findings and supporting evidence</th>
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| Impacts under consideration | Identification of impacts | Based on the sectorial documents available, the main environmental topics are: Materials, Energy, Waste, Ecosystem services including biodiversity, Emissions, Effluents and waste. The main social topics are: Occupational health & safety, local communities, Emergency Preparedness, Involuntary Resettlement, Asset Integrity and Process Safety and Fossil Fuel Substitutes. KPMG confirms that the sector has "high environmental and social impacts."

From the interviews with two NGOs it emerged that the most relevant impacts of Oil & Gas industry are related to climate change and CO₂ emissions. In particular, one interviewed NGO highlighted that the great majority of the Companies within the sector are not aligned with Paris Agreement on 1.5 degrees limit demonstrating to ignore the goals related to climate actions. Sectorial documentation reveals that Oil & Gas companies are not completely addressing their impacts, mainly related to climate change and CO₂ emissions, while being a crucial topic to tackle: a report by PwC affirms that the "integration of climate risk management into your existing risk management approach will be crucial to ensuring your company is well position in the low carbon transition. There are strategic, governance, systems and procurement implications for your consideration". Moreover, Bloomberg agrees on the fact that there are increasing pressures coming from stakeholders on that topic. Interviewed NGOs (two interviews) broadly agree on the fact that Oil & Gas companies are not completely managing their impacts, making very small steps towards the change of their business models, thus confirming the findings from the sectorial documentation analysis. However, findings cannot be intended as exhaustive to extend assumptions on the entire sector. |
| Management of impacts and related gaps | | |
| Evaluation and estimation of the potential impacts linked to the identified impacts | KPIs used to assess environmental impacts | The GRI G4 Sector Specific Disclosures suggests KPIs for non-financial information, in line with main sector impacts. In addition, IPIECA drafted several reporting guidelines focused on the impacts of the sector, starting from "Petroleum industry guidelines for reporting greenhouse gas emissions - 2nd edition". The interviewed NGOs (two interviews) reveal that Oil & Gas companies disclose several information and KPIs that are not completely consistent with their business models. This is also due to the lack of an official/broad framework to be followed, thus companies are disclosing in a vague way. |
| | KPIs used to assess social impacts | |
| | KPIs used to assess economic impacts | |

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47 Global Reporting Initiative ‘G4 Sector Specific Disclosures for Oil & Gas’.
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<th>Areas of analysis</th>
<th>Detail</th>
<th>Main findings and supporting evidence</th>
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<tr>
<td><strong>Level of involvement of the board in the identification and evaluation of the risks</strong></td>
<td>Involvement in the identification and evaluation</td>
<td>Sectorial documents available reports on few initiatives at Board level, in particular: Protiviti(^{18}) reports about a &quot;recent announcement that Royal Dutch Shell is setting carbon emission targets and linking them to long-term executive compensation illustrates the dynamic environment that players in oil and gas face&quot;, showing changes towards a long-term perspective and commitment within the sector. Bloomberg(^{23}) states that &quot;at the annual meetings of Exxon Mobil Corp. and Chevron Corp. on May 29, shareholders will vote on measures to establish board committees that address climate change issues.&quot; However, the information gathered is not sufficient to draw relevant and significant conclusions on the subject.</td>
</tr>
<tr>
<td><strong>Disclosure of impacts related information and sustainability strategy</strong></td>
<td>Actual disclosure and type of document used</td>
<td>Some Oil &amp; Gas companies currently disclose on Non-Financial Impacts as subjected to EU Directive 95/2014. Interviewed NGOs (two interviews) suggest making it compulsory for such companies to report on their impacts, thus recommending having sector sub-sector specific KPIs to allow comparability among companies.</td>
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<td></td>
<td>Existence of a sustainability strategy</td>
<td>The sectorial documents available (that cannot be intended as exhaustive to extend assumptions on the entire sector), reveals different perspectives depending on different actors. In particular, the European Investment Bank(^{48}) &quot;will end financing for fossil fuel energy projects from the end of 2021&quot;, while at the same time, Deloitte(^{49}) reports that &quot;most organisations are not targeting 100 percent, a rising share aims to increase the percentage of renewables in their energy mix to 25 percent, 50 percent, or more over time. Others have set goals to reduce carbon emissions, making renewable deployment a vital prong in their strategies too&quot;, revealing a deep divergence within the industry also due to the fact that &quot;there is no fixed recipe for the journey toward 100 percent renewables&quot;. At the same time, the Vision 2050 of the Business Organisation Fuels Europe affirms that &quot;the industry will continue to develop its assets and business models and to play its part in the energy transition. In the coming decades this will require very significant investments in low-carbon energy solutions. These efforts need to be accompanied by a policy framework based on the principles of technology neutrality, cost-effectiveness and free competition (…) some specific sectors will continue to be mainly dependent on oil.&quot; According to the interviewed NGOs (two interviews), companies are not acting in a sufficient way, committing to Paris Agreement at high level, without evolving business models towards more sustainable frameworks. It is important to set measurable and comparable targets to enhance change, highlighting a large lack of trust among</td>
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<td>Areas of analysis</td>
<td>Detail</td>
<td>Main findings and supporting evidence</td>
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<tr>
<td>Alignment of targets with EU policy priorities</td>
<td>A PwC paper reports that &quot;political decisions on carbon pricing and the other incentives for low carbon investment will have direct impacts on the energy system and implications for efforts to develop carbon capture &amp; storage (CCS), renewable electricity and heat systems&quot;, revealing that the sector must be aligned with European and local targets and policies primarily due to compliance. Furthermore, FuelsEurope states that &quot;achieving these ambitions while maintaining the competitiveness of its economy and the quality of life of its citizens represents an enormous challenge for the EU. In particular, this will require changes in the entire EU energy system and in consumer behaviour&quot;, so sectorial documents available (that cannot be intended as exhaustive to extend assumptions on the entire sector) shows an industry that is still evolving.</td>
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<tr>
<td>No information on this subject has been gathered from interviews.</td>
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<tr>
<td>Consideration of sustainability risks and impacts when defining sustainability targets</td>
<td>FuelsEurope reports that &quot;the development and deployment of low-emission hydrocarbon liquid fuels offer a significant opportunity to effectively meet market demand while also contributing to address the risks posed by climate change&quot;, revealing that energy transition already represents an opportunity within the market, also to directly mitigate the impacts of the industry. At the same time, the representative of NGOs interviewed (two interviews) agree on the fact that oil &amp; gas stakeholders when companies take commitments. The sectorial documents available (that cannot be intended as exhaustive to extend assumptions on the entire sector), reveals different perspectives depending on different actors. In particular, the European Investment Bank &quot;will end financing for fossil fuel energy projects from the end of 2021&quot;, while at the same time, Deloitte reports that &quot;most organisations are not targeting 100 percent, a rising share aims to increase the percentage of renewables in their energy mix to 25 percent, 50 percent, or more over time. Others have set goals to reduce carbon emissions, making renewable deployment a vital prong in their strategies too&quot;, revealing a deep divergence within the industry also due to the fact that &quot;there is no fixed recipe for the journey toward 100 percent renewables&quot;. At the same time, the Vision 2050 of the Business Organisation Fuels Europe affirms that &quot;the industry will continue to develop its assets and business models and to play its part in the energy transition. In the coming decades this will require very significant investments in low-carbon energy solutions. These efforts need to be accompanied by a policy framework based on the principles of technology neutrality, cost-effectiveness and free competition (...) some specific sectors will continue to be mainly dependent on oil.&quot;</td>
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<tr>
<td>According to the interviewed NGOs (two interviews), companies are not acting in a sufficient way, committing to Paris Agreement at high level, without evolving business models towards more sustainable frameworks. It is important to set measurable and comparable targets to enhance change, highlighting a large lack of trust among stakeholders when companies take commitments.</td>
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4.6 Pharmaceutical

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<th>Main findings and supporting evidence</th>
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<tr>
<td>Impacts under consideration</td>
<td>Identification of impacts</td>
<td>The main negative impacts of the pharma sector are environmental ones and they are, at present, well known (as highlighted in the study of the Executive Agency for Health and Consumers(^{50})): in particular, soil and water pollution, which can in turn make the biosphere suffer for biodiversity loss and species extinction. As a confirmation, the European Union &quot;Strategic Approach to Pharmaceuticals in the Environment (PIE)&quot;(^{51}) has been reviewed in 2019 identifying &quot;six action areas concerning all stages of the pharmaceutical life cycle, where improvements can be made. [...] The six areas identified include actions to raise awareness and promote prudent use, improve training and risk assessment, gather monitoring data, incentivise &quot;green design&quot;, reduce emissions from manufacturing, reduce waste and improve wastewater treatment.&quot; Main impacts are related to the risk posed to fish and other wildlife and to potential problems of antimicrobial resistance; such impacts have been also identified by the companies which responded the survey. Regarding social aspects, impacts are perceived mainly as positive, since pharmaceutical innovation improves the lives of millions of Europeans through its contributions to healthcare and wider societal benefits, thus having a positive impact on society (Economic and societal footprint of the pharmaceutical industry in Europe). As stated by the European Federation of Pharmaceutical Industries and Associations(^{51}), the pharmaceutical industry recognises and understands concerns raised by stakeholders regarding the presence of pharmaceuticals in the environment (PIE): thus, the industry is committed to playing a role in addressing concerns about PIE and is actively engaged in minimizing the impact of its activities on the environment. This commitment is partially confirmed by the responses to the survey by two pharmaceutical companies, which adopt audits and risks management processes to...</td>
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<tr>
<td>Management of impacts and related gaps</td>
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\(^{50}\) Mudgal, S., De Toni, A., Lockwood, S., Salès, K., Backhaus, T., Sorensen, B.H. (2013), 'Study on the environmental risks of medicinal products', BIO Intelligence Service project team, Executive Agency for Health and Consumers.

\(^{51}\) European Federation of Pharmaceutical Industries and Associations (EFPIA), 'Pharmaceuticals in the Environment (PIE)'.

companies currently lack a real strategy to address their ESG impact. However, the information gathered is not sufficient to draw relevant and significant conclusions on the subject.
### Areas of analysis | Detail | Main findings and supporting evidence
---|---|---
**Evaluation and estimation of the potential impacts linked to the identified impacts** | KPIs used to assess environmental impacts | According to European Union Strategic Approach to Pharmaceuticals in the Environment (PIE) the management of impacts of the sector shall include the entire supply chain, from the pharmaceutical production to the end-of-pipe control. | KPIs used to assess social impacts | KPIs used to assess economic impacts |
**Level of involvement of the board in the identification and evaluation of the risks** | Involvement in the identification and evaluation | | |
**Disclosure of impacts related information and sustainability strategy** | Actual disclosure and type of document used | The information gathered is not sufficient to draw conclusions on the subject. Many companies are obliged to report on their impacts as per EU 95/2014 Directive. | Existence of a sustainability strategy | According to European Federation of Pharmaceutical Industries and Associations the European pharmaceutical industry is committed to play a role in addressing concerns about Pharmaceutical In the Environment (PIE) and is actively engaged in minimising the impact of its activities on the environment. Following the publication of the European Commission Communication on a European Union Strategic Approach to Pharmaceuticals in the Environment in March 2019, community pharmacists reinforce their commitment to reduce and prevent the impact of pharmaceuticals in the environment. | Alignment of targets with EU policy priorities | Several Member States (e.g. The Netherlands, Sweden), the European Parliament, third countries (e.g. Switzerland), international organisations (e.g. the United Nations, HELCOM, Organisation for Economic Cooperation and Development), industry associations and Non-Governmental Organisations have expressed concerns and taken

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52 European Commission (2019), ‘Communication from the commission to the european parliament, the council and the european economic and social committee. European Union Strategic Approach to Pharmaceuticals in the Environment’.


54 Pharmaceutical Group of European Union (2019), ‘European community pharmacists call for action to reduce the impact of pharmaceuticals in the environment’.
### Areas of analysis

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<th>Detail</th>
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<tr>
<td>Consideration of sustainability risks and impacts when defining sustainability targets</td>
<td>Action to address the growing presence of pharmaceuticals in the environment. At international level, both the United Nations Agenda 2030, in particular Sustainable Development Goal 6, and the 2017 United Nations Environment Assembly ministerial declaration, represent commitments to act in this area, and action on antimicrobial resistance has been agreed by the G7/G20 and World Health Organisation.</td>
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### 4.7 Food

#### Impacts under consideration

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<th>Areas of analysis</th>
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<tr>
<td>Identification of impacts</td>
<td>The main areas of impact on the environmental matrix are biodiversity loss, land use change, biodiversity ecosystem destruction (aspect correlated to sourcing practices and resource efficiency) and packaging waste, as emerged from the sectoral documentary review, from the responses to the survey (according to the two respondents the main impact is land use change) and from the interviews (one NGO and one Business Organisation). Nowadays, as asserted by a representative of a sectoral NGO, more attention is put on climate change impacts, resulting in a lack of comprehension and management of impacts on biodiversity and ecosystems. On the social side, labour management relations and customer health and safety are the aspects that the sector has to put more focus on.</td>
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<tr>
<td>Management of impacts and related gaps</td>
<td>According to OECD-FAO Guidance for Responsible Agricultural Supply Chains enterprises can avoid or, when unavoidable, mitigate the actual and potential adverse impacts of their operations, processes, goods and services by assessing the risks of such impacts over their full life-cycle on an ongoing basis. Nonetheless, as stated by the NGO and business organisation involved in the interviews, the way and extent impacts are managed change according to the size of the enterprise: multinational companies have more resources to make a positive impact, while for SMEs it might be a bit more difficult, even though they work locally and have a shorter supply chain.</td>
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#### Evaluation and estimation of the potential impacts linked to the identified impacts

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<th>Main findings and supporting evidence</th>
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<tr>
<td>KPIs used to assess environmental impacts</td>
<td>The ENVI Protocol from the European Food Sustainable consumption production round table and the GRI Sectoral Disclosure suggest KPIs that can be useful to measure the sustainability impacts of the food and drink sector. Although these sources are available, companies don’t seem to have a common approach as they use different metrics, as reported by the representatives of the business organisation and NGO.</td>
</tr>
<tr>
<td>KPIs used to assess social impacts</td>
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<td>KPIs used to assess economic impacts</td>
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55 GRI G4 Sector Specific Disclosures, 'Food Processing'.

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## Study on directors’ duties and sustainable corporate governance

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<th>Main findings and supporting evidence</th>
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<tr>
<td>Level of involvement of the board in the identification and evaluation of impacts</td>
<td>Involvement in the identification and evaluation</td>
<td>Even though conclusions can hardly be drawn on this aspect, both a sectoral company involved through the online survey and an NGO interviewed agreed that companies’ boards are not involved in the identification and evaluation of risks but still defines sustainability priorities and ensure that sustainability performance is communicated at annual meetings to investors. In some cases, the companies' CSR team is dedicated to this task, but is not given a mandate by the Board, thus still lacking integration within the business model and ERM.</td>
</tr>
<tr>
<td>Disclosure of impacts related information and sustainability strategy</td>
<td>Actual disclosure / type of document used</td>
<td>According to a business organisation interviewed and a company involved in the on-line survey, the companies that are more sustainability-driven include risks and impacts information within their annual financial reporting. Moreover, many companies are now obliged to report on their impacts as per EU Directive 95/2014.</td>
</tr>
<tr>
<td>Disclosure of impacts related information and sustainability strategy</td>
<td>Existence of a sustainability strategy</td>
<td>There is a general commitment of the sector to sustainable actions, as emerged from sectoral documents (A Competitive EU Food and Drink Industry for Growth and Jobs27, Joint Food Wastage Declaration25, EnviFoodProtocol29, ENVIRONMENTAL SUSTAINABILITY VISION TOWARDS 2030\textsuperscript{56}). The Implementation Action Plan's objective is to provide the roadmap for shifting from a conventional mass production model to a more personalised and customised model, involving and engaging consumers while simultaneously promoting flexibility and resource efficiency. This commitment is confirmed by the interview with a sectoral business organisation, according to which food companies are shifting their businesses towards sustainability led by consumers pressures. Still, according to a NGO interviewed, what companies are doing is inadequate, since those actions are qualitative and no specific targets are set.</td>
</tr>
<tr>
<td>Disclosure of impacts related information and sustainability strategy</td>
<td>Alignment of targets with EU policy priorities</td>
<td>The food sector has many EU priorities to align with, e.g. SDG 12, EU commitment to achieve carbon neutrality by 2050 (Implementation action plan 2018 and sectoral business organisation interview), even though, according to the interviews carried out those targets show a level of commitment that is only qualitative and high-level.</td>
</tr>
<tr>
<td>Disclosure of impacts related information and sustainability strategy</td>
<td>Consideration of sustainability risks and impacts when defining sustainability targets</td>
<td>The information gathered is not sufficient to draw conclusions on the subject.</td>
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</table>

\textsuperscript{56} 'Environmental Sustainability Vision Towards 2030', available at [link](#).
### 4.8 Car manufacture

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<tr>
<th>Areas of analysis</th>
<th>Detail</th>
<th>Main findings and supporting evidence</th>
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<tr>
<td>Impacts under consideration</td>
<td>Identification of impacts</td>
<td>Main impacts of the sector:</td>
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<tr>
<td></td>
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<td>- <strong>Climate change and GHG emissions</strong> (i.e. TPI analysis), with a focus on the attention on zero/low emissions mobility made by government, investors and consumers (i.e. Pri- Shifting Perceptions; Acea Progress Report;(^{57}) Tax Benefits &amp; Incentives in the EU)</td>
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<td>- <strong>Raw material selection and consumption/Sustainable procurement</strong>: To monitor and evaluate the impacts related to the automotive supply chain and the importance given by the suppliers to sustainability aspects, &quot;Drive Sustainability developed a common Self-Assessment Questionnaire (SAQ) focusing on social and environmental accountability, business ethics and compliance, and supplier management. The SAQ is globally applicable for all suppliers including sourcing, manufacturing, assembly, retail, and service providers. [...] To date, over 25,000 suppliers have been assessed in more than 100 countries&quot;(^{36}). In addition, Drive Sustainability and the Responsible Minerals Initiative (RMI) worked together to put in place a risk assessment study on raw materials used in the manufacture of automobiles(^{31}).</td>
</tr>
<tr>
<td></td>
<td>Management of impacts and related gaps</td>
<td>- <strong>Monitoring of climate change risks</strong>. According to TPI analysis(^{35}), about the 80% of the automotive companies analysed have a process to manage climate risks; less of 40% undertakes climate scenario planning</td>
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<td>- <strong>Evaluation of the main impacts generated during the entire life cycle of vehicles</strong>. According to PRI(^{32}), &quot;Car lifecycle assessment (i.e. the procedure that measures the impact of a vehicle on the environment from production to use, disposal and eventual recycling) is now a standard practice among major car manufacturers, most of which have adopted the International Organisation of Standards (ISO) Life Cycle Assessment guidelines&quot;.</td>
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<td>- <strong>Working with supplier</strong>. Partners of the automotive sector created a partnership called DRIVE SUSTAINABILITY &quot;to drive sustainability throughout the automotive supply chain by promoting a common approach within the industry and by integrating sustainability in the overall procurement process&quot;(^{36}). The goal is to promote standardisation, collaboration between sector and impact related solutions on supply chain sustainability. Different initiatives and actions are in place (i.e. Training; Periodic dialogue events).</td>
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<td></td>
<td>- <strong>Monitoring of the impacts related to materials used</strong>. Identification of impacts related to raw materials basing on analysis of materials commonly used in the</td>
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\(^{57}\) ACEA (2019), ‘Making The Transition To Zero-Emission Mobility’. 
### Study on directors’ duties and sustainable corporate governance

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<tr>
<td><strong>Areas of analysis</strong></td>
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<td><strong>Main findings and supporting evidence</strong></td>
</tr>
<tr>
<td><strong>Evaluation and estimation of the potential impacts linked to the identified impacts</strong></td>
<td>KPIs used to assess environmental impacts</td>
<td>Manufacture of automobiles. “Two sets of criteria used: 1) material’s importance to industry 2) its associated environmental, social and governance issues. The study started with an initial screening of 50, which was then narrowed to 37 materials commonly found in automotive and electronics products”. <strong>Monitoring of the market and regulatory context</strong>, with a focus on government and consumer preferences. &quot;The European Automobile Manufacturers’ Association (ACEA) will publish a statistical report on an annual basis in the run-up to the mid-term review of Regulation (EU) 2019/631 in 2023, with a view to monitoring the availability of infrastructure and purchase incentives for consumers”33.</td>
</tr>
<tr>
<td></td>
<td>KPIs used to assess social impacts</td>
<td><strong>Emissions and raw materials consumption</strong> Environmental impacts analysis are mainly carried out monitoring KPIs related to GHG emissions and to raw material consumption. For example, among the KPIs monitored in the study, there are: high CO2 emissions, incidences of overlap with areas of conservation, importance, potential for acid discharge to the environment and virgin material consumption. In addition, according to TPI analysis (Management Quality and Carbon Performance of Transport Companies - December 2019), about 90% disclosed Scope 1 &amp; 2 GHG emissions, while less than 80% disclosed any Scope 3 emissions. Environmental KPIs are monitored also in other studies33, where CO2 emissions of new passenger cars placed on the market are reported. Other KPIs monitored are related to water use, waste production and air emissions.58</td>
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<td></td>
<td>KPIs used to assess economic impacts</td>
<td><strong>Human rights and supplier geographical area</strong> Based on the document analysed, a complete evaluation on the sustainability issues linked to the supply chain is carried out monitoring social impacts, too. For example, among the KPIs monitored in the Drive Sustainability and RMI raw materials analysis, there are: child labour and forced labour, incidences of conflict with Indigenous Peoples, artisanal and small-scale mining (ASM) and countries experiencing corruption/high-intensity conflict. Other social KPIs evaluated by the car manufacturer companies are related to HR and HS aspects.</td>
</tr>
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| KPIs used to assess economic impacts | **Incentives, revenues and market shares**. For example: i) purchase incentives for electrically-chargeable vehicles (ECVs), by country; ii) Market shares of fuel types in the EU2833. |

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<th>Areas of analysis</th>
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<tbody>
<tr>
<td><strong>Level of involvement of the board in the identification and evaluation of impacts</strong></td>
<td>Involvement in the identification and evaluation</td>
<td>According to TPI analysis, 35 of the total auto manufacturers analysed, about 70% has nominated a board member/committee with explicit responsibility for oversight of the climate change policy and the 60% incorporates climate change into executive remuneration. It’s also important to consider that Drive Sustainability is governed by two central bodies: - Leadership Assembly that sets strategy, defines priorities and reviews progress and that is composed by Chief Procurement Officers, Procurement Vice-Presidents or similar strategic functions - Steering Committee that controls and supports the strategy implementation and activities progress set by the LA and that involve senior Procurement Officers or equivalent representatives.</td>
</tr>
<tr>
<td><strong>Disclosure of impacts related information and sustainability strategy</strong></td>
<td>Actual disclosure / type of document used</td>
<td>Publication of analysis results and studies made on automotive sector, as the: - The Drive Sustainability Progress Report (next one in 2021) in which are reported the target achieved and the future objectives (for example: suppliers trained on sustainability issues; annual sustainability budget). - Annual UK Automotive Sustainability Report. Inside the document, materiality matrix and key performance indicators are reported; - Disclosure about GHG emissions. According to TPI analysis, about 90% of the analysed company disclosed Scope 1&amp;2 GHG emissions, while less than 80% disclosed any Scope 3 emissions (Management Quality and Carbon Performance of Transport Companies -December 2019); - The European Automobile Manufacturers’ Association (ACEA) will publish an annual statistical report to monitoring and evaluate the availability of infrastructure and purchase incentives for consumers. For example, the distribution of electrically-chargeable vehicles (ECV) charging points across the EU and the correlation ECV infrastructure and surface area, by country.</td>
</tr>
<tr>
<td></td>
<td>Existence of a sustainability strategy</td>
<td>To date, based on document analysed, a common sustainability strategy doesn’t exist, but Drive Sustainability has the goal to define a common sustainability 2030 Strategy for all its members, that will be published on 2020. The 2030 Strategy will be necessary to setting clear strategic directions and targets. However, Drive Sustainability have already defined Guiding Principles (periodically revised) in collaboration with Automotive Industry Action Group (AIAG), that outline “expectations for suppliers on key responsibility issues, including human rights, environment, working conditions, and business ethics. In addition, according to TPI analysis, 35 of the total auto manufacturers analysed, about 50% consider Climate risks/opportunities in strategy and have a policy</td>
</tr>
</tbody>
</table>
### Areas of analysis | Detail | Main findings and supporting evidence
---|---|---
| **Alignment of targets with EU policy priorities** | | commitment to act. One example: TOYOTA ENVIRONMENTAL CHALLENGE 2050. "To help tackle climate change, Toyota has a strategy for achieving zero CO2 emissions in its manufacturing plants by 2050, focusing on improving the technologies it uses and switching to alternative power sources."58. |
| | | The attention given to sustainability issues by governments and institutions is focused on climate change. The most famous example is represented by the Paris Agreement of United Nations. As for all other, automotive companies are requested to do their best efforts to reach the goal of limit the temperature increase. About these efforts, for example, the TPI analysis35 report that of the total auto manufacturers analysed, 41% are aligned with the Paris Pledges benchmark in 2030. Of those, only two are aligned with either of the 2C benchmarks, however. Only Tesla is aligned with 2C (High Efficiency). (see * in Extra notes). |
| | | Legislation directly address to automotive sector is present, too. In fact, on 17 April 2019, the European Parliament and Council adopted Regulation (EU) 2019/631 introducing CO2 emission standards for new passenger cars and light commercial vehicles in the European Union. This regulation set reduction targets of -15% and -37.5% for the tailpipe CO2 emissions of newly-registered passenger cars for the years 2025 and 2030 respectively. These targets will follow on from the target of 95g CO2/km for the year 2021, set in 2013. Car manufacturers that fail to achieve this target must pay a €95 fine per gram from the first gram of exceedance onwards per vehicle sold. Missing the target could be a significant risk for car manufacturers, from a financial and reputational perspective32. |
| | | Furthermore, it's important to underline that OECD realised in 2018 the Due Diligence Guidance for Responsible Business Conduct, whose aim is to provide practical support to enterprises on the implementation of the OECD Guidelines for Multinational Enterprises by providing plain language explanations of its due diligence recommendations and associated provisions. Implementing these recommendations helps enterprises avoid and address adverse impacts related to workers, human rights, the environment, bribery, consumers and corporate governance that may be associated with their operations, supply chains and other business relationships.59 Drive Sustainability approach is aligned with this Guidance. |

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59 OECD, 'Due Diligence Guidance For Responsible Business Conduct'.
**Areas of analysis** | **Detail** | **Main findings and supporting evidence**
--- | --- | ---
| | Consideration of sustainability risks and impacts when defining sustainability targets | The information gathered is not sufficient to draw conclusions on the subject.

**Extra notes**

* - TPI’s Carbon Performance assessment tests the alignment of company targets with the UN Paris Agreement goals*. We use 3 benchmark scenarios for each sector. For autos and airlines these are:
1. Paris/International Pledges, consistent with emissions reductions pledged by countries as part of the Paris Agreement (i.e. NDCs) and through other international forums (e.g. the International Civil Aviation Organisation);
2. 2 Degrees (Shift Improve), consistent with the overall aim of the Paris Agreement, albeit at the low end of the range of ambition;
3. 2 Degrees (High Efficiency), a variant of the previous scenario that assumes there is no shift in passengers to lower carbon modes of transport; instead all emissions reductions are delivered through increased fuel efficiency and low carbon technology.

### 4.9 Transport

**Areas of analysis** | **Detail** | **Main findings and supporting evidence**
--- | --- | ---
| **Impacts under consideration** | Identification of impacts | The analysis of available sectorial documentation shows that the main environmental implications of the transport sector are GHG and air pollutants emissions (according to European Environmental Agency[^60] and the ESG industry report card[^37]), as the transport sector is one of the biggest emitting sector in Europe. This is confirmed by the feedback of the two representatives from a business association and an NGO interviewed.

In addition, and according to the representative of the sectorial business organisation, the real challenge is that the sectorial objective of increasing efficiency (i.e. fastest deliveries which are often managed by transport on wheels) clashes with today’s expectations to reduce environmental impacts.

Finally, according to the NGO and BO interviewed (two interviews), there are additional social impacts related to the effects of pollution on people health and to the working conditions of people employed (also throughout the supply chain).

**Management of impacts and related gaps** | According to the representatives of the business organisation and the NGO involved (two interviews), companies in this sector are rarely ahead of regulation, and have a reactive rather than a proactive approach to ESG aspects and minimisation of ESG risks and impacts. Moreover, the clash between increasing efficiency and reducing

[^60]: European Environment Agency (2018), ‘Progress of EU transport sector towards its environment and climate objectives’.
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<tr>
<td>Environmental impacts is also confirmed by the European Environmental Agency, according to which “emissions from the EU transport sector are not reducing enough to limit its environmental and climate impacts in Europe”. Nevertheless, the sensitivity and awareness on sustainability topics is growing, leading some larger companies put in place some actions towards a more sustainable business (e.g. ship engines working with less polluting fuels).</td>
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<tr>
<td><strong>Evaluation and estimation of the potential impacts linked to the identified impacts</strong></td>
<td>KPIs used to assess environmental impacts</td>
<td>Many different KPIs are available to estimate the sector’s sustainability impacts, especially on environment (e.g. GHG emissions, pollutant emissions rate). Still, those KPIs are just guidelines that companies can align with, but that do not represent the universal practice of companies within the sector, as companies are more reactive to regulatory requirements than proactive.</td>
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<tr>
<td>KPIs used to assess social impacts</td>
<td>Some KPIs are available to estimate the social impacts of the transport sector, such as: number of accidents and related rates, population exposed to and annoyed by traffic noise, by noise category and by mode associated with health, etc. Still, those KPIs are just guidelines that companies can align with, but that do not represent the universal practice of companies within the sector, as companies are more reactive to regulatory requirements than proactive.</td>
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<tr>
<td>KPIs used to assess economic impacts</td>
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<td></td>
</tr>
<tr>
<td><strong>Level of involvement of the board in the identification and evaluation of the risks</strong></td>
<td>Involvement in the identification and evaluation</td>
<td>The information gathered is not sufficient to draw conclusions on the subject. According to the sector NGO interviewed, only a few boards have expertise on sustainability issues.</td>
</tr>
<tr>
<td><strong>Disclosure of impacts related information and sustainability strategy</strong></td>
<td>Actual disclosure and type of document used</td>
<td>According to the sectoral NGO interviewed, the actual disclosure of the transport sector’s impacts is mainly included in non-financial reporting reports.</td>
</tr>
<tr>
<td>Existence of a sustainability strategy</td>
<td>Even though no specific information on this aspect emerged from the desk research on sectorial documents, the representative from the business organisation and NGO involved (two interviews) stated that larger companies are starting to mature their awareness on ESG challenges, putting in place initiatives to reduce their impacts.</td>
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<tr>
<td>Alignment of targets with EU policy priorities</td>
<td>According to the European Environmental Agency the EU has set some targets for the transport sector, to which companies should align with. Nevertheless, the latest data available on past trends show that the EU transport sector is currently not on track to reach the policy targets on total GHG emissions over the last four years, on average CO₂ emissions from new cars for the first time in 2017, on oil consumption, and on</td>
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<td></td>
<td>Consideration of sustainability risks and impacts when defining sustainability targets</td>
<td>energy use from renewable sources. These data can be indirectly read as a lack of alignment of companies with the EU's emission reduction targets.</td>
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4.10 Chemical industry

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<th>Main findings and supporting evidence</th>
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<tr>
<td>Impacts under consideration</td>
<td>Identification of impacts</td>
<td>All the business organisation and the companies involved in the study through the survey (4 stakeholders, of which 3 business organisation and 1 company) agreed that the main impacts of the sector are chemical pollution, release of novel entities created entirely by humans and health and safety. Also, climate change resulted as one of the most relevant impacts of the chemical industry (according to three stakeholders and a representative of the NGO interviewed). In addition, discrimination, human rights and labour rights have been indicated as impacts related to the activities of the sectorial companies (2 out of 4 responses to the on-line survey). These impacts are also core in the Chemical Sector SDG Roadmap,(^{62}) which focuses its attention on five &quot;impact opportunities&quot;: food, water, health and safety, energy and infrastructures and cities.</td>
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</table>
| Management of impacts and related gaps | | According to the three business organisation which responded to the on-line survey, the process for the identification of impacts is done through:  
- Audits  
- Contract management (inclusion of sustainability specifications)  
- Due diligence (for sustainability impacts throughout the supply/value chain).  
As stated by the business organisation interviewed and as confirmed by the number of sectorial paper on these aspects (Chemical Sector SDG Roadmap,\(^{62}\) Responsible Global Charter,\(^{63}\) Teaming up for a sustainable future\(^{64}\)), actions have been developed to address those main material topics by the companies within the sector. |

| Evaluation and estimation of the potential impacts linked to the identified impacts | KPIs used to assess environmental impacts | Within the Responsible Care®\(^{63}\) programme chemical companies report openly on performance, achievements and shortcomings based on Key Performance Indicators (KPIs): this voluntary programme has been implemented by 58 chemical associations in more than 60 countries around the globe. No specific other information have been gathered through the survey and interviews. |
| Evaluation and estimation of the potential impacts linked to the identified impacts | KPIs used to assess social impacts | |
| Evaluation and estimation of the potential impacts linked to the identified impacts | KPIs used to assess economic impacts | |

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\(^{63}\) The international council of chemical associations (2014), ‘Responsible Care®Global Charter’.  
\(^{64}\) Cefic ‘Teaming up for a sustainable Europe. Cefic sustainability charter’.
### Areas of analysis

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<th>Main findings and supporting evidence</th>
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<tbody>
<tr>
<td><strong>Level of involvement of the board in the identification and evaluation of the risks</strong></td>
<td>Involvement in the identification and evaluation</td>
<td>According to 2 BO and 1 company (from the on-line survey), the board is involved in the identification of sustainability risks and impacts. Main activities in which the board is involved: - Define sustainability priorities (3 responses, of which 1 company) - Ensure that the company’s sustainability strategy and performance are communicated at annual meetings and to investors (2 responses) - Oversee the implementation of the strategy and ensure that key targets are being met (3 responses, of which 1 company) - Set measurable sustainability targets (2 responses, of which 1 company) No additional conclusions could be drawn from the documentary review.</td>
</tr>
<tr>
<td><strong>Disclosure of impacts related information and sustainability strategy</strong></td>
<td>Actual disclosure and type of document used</td>
<td>No relevant conclusions can be drawn based on the analysis carried out; anyway, it is worth to notice that many companies belonging to the chemical sector voluntary send data and information to Responsible Care®. In particular, they &quot;submit KPI performance data on an annual basis to national associations of the countries in which they operate. These are then reported as national level aggregates to the ICCA (the International Council of Chemical Associations). For its European members, Cefic converts national level aggregates into European level aggregates that reflect the overall performance of companies operating in Europe. These aggregates are published by Cefic with the intention to showcase the industry’s progress.”</td>
</tr>
<tr>
<td><strong>Existence of a sustainability strategy</strong></td>
<td></td>
<td>According to the sectorial documentary review, there are many strategies put in place by chemical associations: - The Sustainability Charter puts the vision of the chemical industry into operation and defines a pathway to sustainability - The Responsible Care is the global chemical industry’s unifying commitment to the safe management of chemicals throughout their life cycle, while promoting their role in improving quality of life and contributing to sustainable development. During the 2nd Green and Sustainable Chemistry Conference in Berlin last year, the roundtable gave industry leaders from companies a chance to debate what counts as ‘green’ and ‘sustainable’ for their organisations. This is in contrast with what the representative of the sectoral NGO says (1 interview), who stated that the sustainability approach of the chemical sector is only driven by regulation, and without it a company can choose whether to behave well or not.</td>
</tr>
<tr>
<td><strong>Alignment of targets with EU policy priorities</strong></td>
<td></td>
<td>The approach of chemical industries to sustainability is leaning forward the achievement of the SDGs. This is clear going through the sectorial documentation available online (Chemical Sector SDG Roadmap, Global Chemical Industry</td>
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<tr>
<td>Areas of analysis</td>
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<td>Main findings and supporting evidence</td>
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<tr>
<td></td>
<td>Consideration of sustainability risks and impacts when defining sustainability targets</td>
<td>Contributions To The Sustainable Development Goals(^{66}), but is also confirmed by the business organisation involved (three through survey and one through interview). In addition, two business organisation (responses from the on-line survey) affirmed that the strategies of the sector are also aligned with Paris agreement.</td>
</tr>
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\(^{66}\) The International Council of Chemical Association (ICCA) (2017), ‘Global chemical industry contributions to the sustainable development goals’. 
### 5 RELEVANT SUSTAINABLE CORPORATE GOVERNANCE INITIATIVES IN THIRD COUNTRIES

#### 5.1 Australia

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| Company’s interest    | “Corporations Act 2001” does not provide a definition of company’s interest. However, through the case law is possible to detect the concept. In particular, in “Darvall v North Sydney Brick & Tile Co Ltd (No. 2)” (i), the New South Wales Supreme Court stated that the company’s interests encompass interests of present and future shareholders, as well as the company as a commercial entity and as a going-concern. The reference to ‘future shareholders’ is a reference to ‘the long-term interests of the company’. As is generally treated in the Australian Common law, the short-term interests of shareholders will not always align with the interests of the company as an entity, as of yet there is no case law requiring directors to consider long-term consequences of corporate decisions. (ii) According to the Australian Securities Exchange (“ASX”) Corporate Governance Principle 3’s Commentary (iii), at the Principle 3, it is recommendable to endorse investors’ and community’s expectations emphasizing the importance of building ‘long term sustainable value’ for the company’s investors. Australia has not yet adopted a legal form specifically for social enterprise. However, B Lab Australia and New Zealand Ltd (B Lab), the Australian subsidiary of the US entity that developed the benefit corporation structure, is lobbying for the Corporations Act to be amended to create a hybrid form known as a ‘benefit company’, with similar features to a US benefit corporation. (iv) | (i) “Darvall v North Sydney Brick & Tile Co Ltd (No. 2)”, and See, e.g., Vines v ASIC (2007) 73 NSWLR 451, [786];  
<p>| Directors’ duty of care | There are no provisions set by law requiring companies to consider sustainability. However, the “Corporations Act 2001” and the general law, require Directors and other officers to act in good faith in the best interest of the corporation (i). | (i) “Corporations Act 2001” under Section 181(1)(a); |</p>
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<td>Companies listed on Australian Securities Exchange must comply with the ASX Listing Rules. Listed Companies are also expected to comply with the “ASX Corporate Governance Principles and Recommendations” or explain their failure to do so. The Principles are promulgated by the ASX Corporate Governance Council and contain numerous provisions that encourage sustainable business practices. Principle 3 directs companies to ‘instill a culture of acting lawfully, ethically and responsibly’, and this provision, therefore, have increasingly emphasised the role of corporate culture in ensuring good governance. (ii) A notable point from a 2018 draft of the &quot;Fourth Edition of Corporate Governance Principles” was its reference to the risk to a company’s social licence to operate if it does not conduct 'its business in a way that is [...] environmentally or socially responsible'. This point was controversial and ultimately removed, but the initial reference nevertheless reflects a growing focus in Australia on the risk that companies’ practices do not meet community expectations. Further, according to the ASX Corporate Governance Code, the Recommendation 7.2 and 7.4 an entity is required to have in place a Risk Management Framework and to assess material exposure to environmental &amp; social risks and the manner in which these are managed. (iii) As concerns the relation between directors’ duties and climate risks in the Australian legal context, a 2016 legal opinion commissioned by the Centre for Policy Development found that climate change risks may be relevant to a director's duty of care and diligence to the extent that those risks intersect with the interests of the company (e.g. in so far as they present corporate opportunity or foreseeable risks to the company or its business model), and that directors who fail to consider climate change risks now could be found liable for breaching their duty of care and diligence in the future. The legal opinion was provided by Noel Hutley SC and Sebastian Hartford-Davis on instruction from MinterEllison’s lawyer Sarah Barker, who is strong advocate for bringing the financial risk of climate change into the boardroom. (iv) A supplementary opinion released in 2019 concluded that the exposure of individual directors to climate change litigation is increasing, as it is increasingly difficult for directors of companies to pretend that climate change will not intersect with the interests of their companies. (v)</td>
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<td>(v) Hutley SC, N. and Hartford-Davis, S. (2019), Climate Change and Directors’ Duties, Supplementary Memorandum of Opinion</td>
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67 The social license to operate (SLO) refers to the ongoing acceptance of a company or industry's standard business practices and operating procedures by its employees, stakeholders, and the general public.

### Area of analysis

**Estimations of sustainability risks and impacts**

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<td>In particular, a listed entity should disclose whether it has any material exposure to environmental or social risks and, if it does, how it manages or intends to manage those risks. 'Material exposure' includes risks to a listed entity’s ability to create or preserve value for security holders over the short, medium or longer term. In addition, Recommendation 7.2 &amp; 7.4 require the entity to have in place a &quot;Risk Management Framework&quot; and assess material exposure to environmental and social risks and the manner in which these are managed. Environmental and social risks include: Activities that adversely affect human society or are adversely affected by human society; The risks associated with large scale mass migration, pandemics or shortages of food, water or shelter; The risks associated with the entity polluting, the environment, adding to the carbon levels in the atmosphere, or threatening a region’s biodiversity or cultural heritage; and The risks for the entity associated with climate change, reduced air quality and water scarcity.</td>
<td>(ii) Victoria Schnure Baumfield (2019), “The Australian paradox: conservative corporate law in a progressive culture”, in Cambridge Handbook of Corporate Law, Corporate Governance and Sustainability;</td>
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<tr>
<td>In addition, the Commentary to Recommendation 7.4 elaborates on environmental risk related to climate change, including risks related to the transition to a lower-carbon economy. It warns, many listed entities will be exposed to these types of risks, even where they are not directly involved in mining or consuming fossil fuels.</td>
<td>(iii) M. Foo, A Review of Socially Responsible Investing in Australia: An independent report for National Australia Bank by the Australian Centre for Financial Studies at Monash Business School, Australian Centre for Financial Studies, May 2017;</td>
</tr>
<tr>
<td>Institutional investors’ attention to sustainability has increased significantly over the past decade, with major effects for Australian listed companies. As of 2017, Mr. Maw Der Foo in one of his studies reported that 70% of Australia’s 50 largest superannuation funds 'have made some form of public commitment to responsible investing'.</td>
<td>(iv) Australian Council of Institutional Investors, ACSI Governance Guidelines: A Guide to Investor Expectations of Listed Australian Companies, November 2017, p. 3, 5.</td>
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<td>As a significant example, the Australian Council of Superannuation Investors (ACSI), representing institutional investors who collectively manage over $1.6 trillion in assets and own on average 10% of every ASX200 company, issued in 2017 the revised Governance Guidelines for investors that emphasise sustainability. The Guidelines summarise ACSI 'members' expectations about the governance practices of the companies they invest in. Their 'core principles' include board oversight of material risk, including environmental, social and governance (“ESG”) risks, and 'sustainable, long-term value creation'.</td>
<td>(v) Financial Services Council, FSC Standard 23: Principles of Internal Governance and Asset Stewardship, July 2017 (FSC Stewardship Code).</td>
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| Board remuneration      | Furthermore, the Australian Financial Services Council (“FSC”) instituted a mandatory comply-or-explain Stewardship Code for asset managers (i.e., investment managers or fund managers) effective from 1\° January 2018. \((v)\)  
The Stewardship Code requires asset managers to clearly articulate their investment principles and internal governance standards. They must disclose their approach to considering ESG factors 'and whether these considerations influence investment decision-making and company engagement'. \((ii)\)  
The “Corporations Act” establishes that only listed companies must present a remuneration report to shareholders at every annual general meeting showing the board's policies for determining the nature and amount of remuneration paid to key management personnel (which includes any director), the relationship between the policies and company performance, an explanation of performance hurdles and actual remuneration paid to key management personnel. \((i)\)  
“Corporations Act 2001” under Section 300A                                                                                                                                                                                                                           |
| Board composition       | We did not detect any provision requiring including individuals with specific expertise on sustainability in the board of directors.                                                                                                                                                   | \((i)\) Victoria Schnure Baumfield (2019), “The Australian paradox: conservative corporate law in a progressive culture”, in Cambridge Handbook of Corporate Law, Corporate Governance and Sustainability; \((i)\) “Corporations Act 2001”                                                                 |
| Stakeholder involvement | As highlighted by Ms. Victoria Schnure Baumfield, the closest thing to a strong sustainability requirement is the so-called carbon tax, which was repealed in 2014.\(^69\) \((i)\)                                                                                                                                 | \(69\) From the Victoria Schnure Baumfield's perspective, the sustainability is a concept in which Australian business population believes, not having the statutory law in support of at the moment. It is a progressive culture \((v. \text{ reporting disclosure section})\) because there have always been initiatives regarding the sustainability matter : \(i.e.\) carbon tax, NSW and because it is going towards a sustainability-oriented country. |
| Enforcement             | According to the Corporations Act, a director committing a fraud or a bribery offence in breach of directors' duties under the Corporations Act, can be personally liable for loss caused by a breach of his/her duties.  

In extreme cases involving dishonesty and recklessness, a director can face:  
- Prosecution by the Australian Securities and Investments Commission;  
- Civil penalties of up to AUD200,000; and/or up to five years' imprisonment.  

Moreover, the “Corporations Act, 2001” sets forth that a Director who fails to perform their duties may be liable for a civil penalty under section 1317E. They may also be guilty of a criminal offence with a penalty of up to a maximum of $200,000, or imprisonment for up | \((i)\) “Corporations Act 2001”                                                                                                                                                                                                                                           |
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<td><strong>Reporting and disclosure</strong></td>
<td>According to the Corporations Act 2001 directors must disclose the relevant environmental, social and financial information.</td>
<td>(i) &quot;Corporations Act 2001&quot; in Sections 298, 299 and 300;</td>
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|                       | The "Corporations Act" (for listed Companies only) requires each company, registered scheme or disclosing entity, to prepare a Directors Report for each financial year which gives an overview of the company's operations, the future events and their effect on the company and environmental regulations affecting the company. (i)  
Australia has not traditionally required any non-financial sustainability reporting on economic, social and environmental performance except that companies’ subject to ‘particular and significant environmental regulation’ must ‘give details of the entity’s performance in relation to environmental regulation’.  
The Corporations Act, Principles, and ASX Listing Rules impose interwoven obligations on directors to continually focus on, assess and where necessary disclose their sustainability risks. (ii)  
Mandatory non-financial sustainability reporting is being strengthened, however. In June 2018, the state of New South Wales ("NSW") adopted a Modern Slavery Act for companies with turnover of $50 million or more and an NSW presence. The Act requires those companies to disclose (to the competent Minister) a statement about the likelihood of conditions including slavery, servitude, forced labour, human trafficking, debt bondage and sexual servitude in their supply chains, with penalties up to $1.1 million (Australian dollars) for non-compliance. Similar federal legislation entered into force in December 2018. Moreover, the Commonwealth Modern Slavery Act 2018 has entered into force on 1st January 2019 and it has been pointed out as a national provision. (iii)  
The 2007 National Greenhouse and Energy Reporting ("NGER") Act is the most prominent reporting requirement in Australia. NGER creates a mandatory, national reporting framework for the largest 500 corporate entities by greenhouse gas emissions and energy. (iv) "The National Greenhouse and Energy Reporting Act". See also "Germanwatch, CAN and  
70 A managed investment scheme is a scheme that enables a group of investors to contribute money that is pooled for investment to produce a financial benefit; the members of the scheme (investors) are not active in controlling the scheme’s day-to-day operations.  
71 Under section 111AC of the Corporations Act 2001, a Disclosing Entity ("DE") is a corporation that issues Enhanced Disclosure securities ("EDS"). whether or not the corporation is listed on an Australian stock exchange. As the Company falls into this category it is regarded as an ‘unlisted DE’.  
72 For most Australian entities the first Reporting Period will be from 1 July 2019 to 30 June 2020, to be given to the Minister within 6 months after the end of the reporting period for the entity, in a manner approved by the Minister. As such for entities on an Australian financial year the first Annual Report is due by 31 December 2020. However, for entities which have an international reporting period the reporting periods may differ. | (ii) Victoria Schnure Baumfield (2019), “The Australian paradox: conservative corporate law in a progressive culture”, in Cambridge Handbook of Corporate Law, Corporate Governance and Sustainability; (iii) Modern Slavery Act 2018 |
### Area of analysis | Description of the initiative | Source
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Production/consumption to report this data. From 2012 (until its repeal in 2014), a carbon pricing mechanism was integrated into the NGER system. The repeal is among the reasons why Australia has been ranked as a "very low-performing" country in Germanwatch's analysis of countries tackling climate change. However, the reporting requirement still exists and represents the longest unbroken national mandatory GHG reporting scheme in the world. (iv)

On a social side, the Workplace Gender Equality Act requires companies with over 100 employees to report against a set of standardised gender equality indicators, which include composition of workforce and governing bodies, remuneration, availability of flexible working arrangements, gender-based harassment and discrimination. The reporting requirement was the inspiration for the UK's Gender Pay Gap Reporting, whose scope for disclosure is far narrower than the Workplace Gender Equality Act. (v)

#### 5.2 Canada

**Area of analysis | Description of the initiative | Source**

**Company’s interest**

The concept of "company's interest" is not defined by the Canadian law, even if the case law (e.g. People v Wise; BCE v Debentureholders; Teck v Millar) uses to refer to it stating that the "best interest of the corporation" should be read not simply as the best interest of the shareholders.

The Supreme Court in BCE v Debentureholders, for instance, stated that the directors, in considering what is best for the corporation must take into account a broad range of affected stakeholders. Indeed, directors shall not confine the fiduciary duty in the short-term profit but have to consider the long-term interests of the corporation which includes shareholders' interests, employees', creditors', consumers', government's and the environment.

The concept of "company's interest" is not defined by the Canadian law neither in Canada Business Corporation Act ("CBCA") nor in the Ontario Business Corporations Act ("OBCA"). However, there are overarching principles related to conducting business in the best interest of the corporation developed by case law, and in particular in:

- *Peoples Department Stores Inc. v Wise* the Supreme Court of Canada stated that the best interest of the corporation includes both the interest of the shareholders and the interest of the stakeholders. "Insofar as the statutory fiduciary duty is concerned, it is clear that the phrase the “best of the corporation” should be read not simply as the “best interests of the shareholders” (...) We accept as an accurate statement of law that in determining whether they are acting with a view to the best interests of the corporation it may be legitimate, given all the circumstances given case, for the board of directors to consider,

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| NewClimate Institute (2017), Climate Change Performance Index: Results 2018”.

(v) "Workplace Gender Equality Act 2012” – and "The Climate Disclosure Standards Board (CDSB) |

(i)Peoples Department Stores Inc. (Trustee of) v Wise (Peoples)

(ii)Teck Corp Ltd v Millar, (1972), 33 DLR (3d) 288 (BCSC)

(iii)BCE Inc. v 1976 Debentureholders (BCE)
### Area of analysis | Description of the initiative | Source
--- | --- | ---
inter alia, the interests of shareholders, employees, suppliers, creditors, consumers, governments and the environment.” (i)

- *Teck Corporation Limited v Millar* decision, where the Court recognised that (a) on the one hand, it would be a breach of directors’ duty to disregard entirely the interests of a company's shareholders in order to confer a benefit on its employees, but (b) on the other hand, the fact that directors observe a decent respect for other interests lying beyond those of the company's shareholders in the strict sense, that would not leave directors open to the charge that they have failed in their fiduciary duty to the company. (ii)

- *BCE v Debentureholders*, the Court affirmed that directors must act in the best interests of the corporation, and in doing so, may consider the interests of various affected groups, including shareholders and debenture holders, but are not required to do so. Ultimately, the directors must act in the best interests of the corporation and its operations. The role of the court is not to second guess the business decisions of the directors, who are expert business persons, but rather to ensure that a legally sound decision-making process was followed. (iii)

**Directors’ duty of care**

**Under Canadian corporate law, directors and officers have two primaries statutory duties: a fiduciary duty to act honestly and in good faith with a view to the best interests of the corporation; and a duty of care to exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.**

Besides, “the best interest of the corporation” includes the duty to assess, fairly and equitably, the impact of the corporation’s actions and decisions on its stakeholders. (i) (iii)

The *reasonable care* (which is a general concept, applicable to all types of companies) that directors should use in managing a company also includes:

- Establishing an environmental policy;
- Implementing a proper system for preventing breaches of environmental laws;
- Establishing an effective internal compliance and reporting system. (i)

The CEPA provides that directors must take all reasonable care to prevent the company they serve from contravening environmental laws. (iii)


IGOPP (Institute for Governance of Private and Public Organisations) – ”What is the board’s responsibility to stakeholders other than shareholders?”, 2014

(ii)BCE at para 36.

(iii)CEPA, art.157

(iv) Sarra, J. (2018), ‘Fiduciary Obligations in Business and Investment:”

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73 “I appreciate that it would be a breach of their duty for directors to disregard entirely the interests of a company’s shareholders in order to confer a benefit on its employees... But if they observe a decent respect for other interests lying beyond those of the company's shareholders in the strict sense, that will not, in my view, leave directors open to the charge that they have failed in their fiduciary duty to the company”.
Furthermore, as highlighted in a recent study of Poonam Puri, Canadian corporate law has limitations when it comes to encouraging corporations to adopt environmentally-friendly policies. These limitations can be seen in the following reasons:

- Corporate law develops in the courts;
- A party must have a standing to bring a lawsuit and shape the company’s environmental policy;
- Lawsuits are expensive and lengthy;
- Canadian courts have never held a lawsuit for a director non-acting in the best interest of his company because he or she did not comply with the climate change – or environmental policies.

Finally, some authors maintain that, in Canada, addressing climate change risks could be already considered as part of directors’ duties in determining the best interest of the company:

“The statutory obligation that directors act honestly and in good faith, and act diligently in supervising and managing the corporation’s affairs, necessarily means that they must engage with the issues of physical and transition climate change risks. Depending on the firm’s economic activities, the risk may be minor or highly significant, but directors and officers have an obligation to make the inquiries, to devise strategies to address risks, and to have an ongoing monitoring and adjusting plan to ensure the strategy continues to be responsive to the risk. [...] Addressing climate risk is the responsibility of directors and officers in determining the best interests of the corporation. In addition to this fiduciary obligation, the duty of care requires directors and officers to exercise the care, diligence and skills that a reasonably prudent person would exercise in the circumstances; and arguably, this duty requires directors and officers to identify and develop a strategy to supervise and manage the transition that will address the specific risks posed by climate change. [...] the SCC [Supreme Court of Canada] has recognised that directors and officers need to look to the long-term interests of the corporation. As long as the decision was a reasonable one at the time, courts will defer to directors’ decisions. That means that where directors and officers are duly diligent in trying to identify climate-related financial and other risks, and take action to mitigate and adapt, they will not face personal liability risk. Acting prudently and on a reasonably informed basis is what is required. At the same time, failure to consider climate change risk does leave directors and officers open to actions against the corporation and in some cases, the directors and officers personally”.

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<tr>
<td>Estimations of sustainability risks and impacts</td>
<td>The Canadian corporate law contains specific provisions related to certain environmental risks.</td>
<td>(i)Canadian Environmental Protection Act, 1999 (CEPA) – C33, Section 162</td>
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<td>The CEPA stated that:</td>
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### Area of analysis | Description of the initiative | Source
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| **Board remuneration** | Every company shall submit to the Minister, in the prescribed form and manner and at the prescribed time, a report setting out, with respect to a prescribed period, an account of any emission credits obtained or applied by the company and a description of each of the following vehicles, engines or pieces of equipment for which credits were obtained or applied:

(a) vehicles, engines and equipment to which the company applied a national emissions mark during that period, other than those that were exported;

(b) vehicles, engines and equipment bearing a national emissions mark that were sold by the company in Canada during that period; and

(c) vehicles, engines and equipment that were imported by the company during that period for the purpose of sale in Canada.”

There are no indications regarding the criteria that a company should follow for fixing the directors’ remuneration.

According to the CBCA the Board’s remuneration is disciplined in all the types of companies and in all the sectors. The remuneration shall be reasonable depending on the circumstances and may be governed by jurisprudence depending on the scenario. (i)

Indeed, the CBCA stated that:

[125] Subject to the articles, the by-laws or any unanimous shareholder agreement, the directors of a corporation may fix the remuneration of the directors, officers and employees of the corporation.

The remuneration of directors does not have to be approved by the shareholders of a company. However, public companies are increasingly incorporating advisory, non-binding “say-on-pay” shareholder resolutions into their corporate governance regime, and recent changes to the CBCA, once in force, are expected to require a say-on-pay vote for public companies. The Toronto Stock Exchange (TSX) requires listed companies to receive shareholder approval for compensation plans (such as stock option and similar plans) that provide certain equity-based compensation arrangements to its directors, officers and others. (i)

Board composition | We did not detect any provision requiring the inclusion of individuals with specific expertise on sustainability in the board of directors. | (i)R.S.O. 1990, c. C.38, s. 283 (2).

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74 The emission credit is a compensation system provided for in the Kyoto Protocol for the protection of the environment, which allows countries that produce more polluting gases than the permitted level to subsidise the implementation of projects aimed at reducing pollution in developing countries.

75 The National Emissions Mark (NEM) is required to be affixed by any regulated trailer manufacturer’s products prior to shipment. The label indicates that the trailers meet the Heavy Duty Greenhouse Gas requirements for Trailers.
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<td>According to the OBCA, the board of directors shall consist of a fixed number of directors not fewer than three. (i)</td>
<td>(i) Art. 241 CBCA</td>
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<td><strong>Stakeholder involvement</strong></td>
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<td>Neitherr stakeholders nor shareholder are involved in designing the sustainability strategy.</td>
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<td>According to Canadian corporate law when a company fails to prevent environmental contraventions through reasonable care, directors can be personally liable for directing, authorising, participating in, or acquiescing to, that conduct (regardless of whether the company is charged or convicted).</td>
<td>(i) Art. 241 CBCA</td>
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<td>Through the oppression remedy a complainant can bring an application against a corporation or director where conduct has occurred which is oppressive, unfairly prejudicial or unfairly disregards the complainant's interests. This can include coercive, abusive or bad faith conduct.</td>
<td>(ii) Canada Business Corporation Act</td>
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<td>If the complainant is successful, this may lead to direct compensatory damages, dissolution of the corporation, amendment of the corporation’s by-laws.</td>
<td>(iii) CSA Staff Notice 51-358; 51-354</td>
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<td>A &quot;complainant&quot; is deemed to be a current or former registered security holder, a current or former director or officer, the Director appointed under the CBCA, or &quot;any other person who, in the discretion of a court, is a proper person to make an application under this Part&quot; and virtually, this concept can include also NGOs and employees. (i)</td>
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<tr>
<td><strong>Enforcement</strong></td>
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<tr>
<td>Reporting and disclosure</td>
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<td>According to the Canadian corporate law and similar provincial corporate legislation, directors are required to disclose a company's annual financial statements and the report of the auditor, if any. There are no provisions related to the disclosure of environmental information, but the CEPA and the CSA define sustainable guidelines suggesting the directors to disclose information about corporation's emissions, financial impacts and possible risks.</td>
<td>(ii) Canada Business Corporation Act</td>
</tr>
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<td>The Canadian Institute of Chartered Accountants (&quot;CICA&quot;) review of environmental reporting finds that only 381 out of 863 Canadian 1993 annual reports include environmental information.</td>
<td>(iii) CSA Staff Notice 51-358; 51-354</td>
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<td>The federal government of Canada has recently made amendments to the CBCA that will, once in force, require public companies incorporated under Canadian law to disclose to shareholders, at every annual shareholders' meeting, certain prescribed diversity information(^{76}) relating to the directors and members of senior management. (ii)</td>
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\(^{76}\) Diversity information means the disclosure of the number of male and female members of the board of directors and the senior management.
Publicly traded companies must disclose fees and other benefits paid to the directors of the company.

The Canadian Securities Administrators ("CSA") issued CSA Staff Notice 51-333 in 2010, which set out guidance for environmental reporting. In 2018, the CSA issued CSA Staff Notice 51-354, followed by CSA Staff Notice 51-358 in August 2019:

- Under Staff Notice 51-354, the CSA indicated that it would continue to monitor the quality of disclosure of climate change-related matters by public companies and would consider implementing new disclosure requirements.
- Staff Notice 51-358 reinforces the earlier guidance set out in Staff Notice 51-333 but, encouraged by increased investor interest and developments globally and in Canada, emphasises the increasing pervasiveness of climate change risks and the potential difficulties in assessing their materiality.

Corporate governance standards for public companies in Canada are set out in corporate statutes and in securities laws and regulations. These include the National Instrument 58-101 on the disclosure of corporate governance practices, National Policy 58-201, Corporate Governance Guidelines, and National Instrument 52-110 on Audit Committees. In addition, in 2018 the Canadian Securities Administrators released its Report on Climate change related Disclosure Project, to review the disclosure of risks to, and financial impacts on, companies associated with climate change and sustainability and the governance processes related to them. (iii)

In Canada the following relevant sustainable corporate governance initiatives could be identified:

- Oppression remedy: According to Art. 241 of the CBCA the oppression remedy is a legal instrument used in the Canadian corporate law, such as in the other Commonwealth countries, which refers to "any other person who, in the discretion of a court, is a proper person to make an application under this Part" 's empowerment to bring an action against the corporation in which he/she owns shares when the conduct of the company is oppressive and unfairly prejudicial.

- Shareholder Proposals: According to Art. 147 of the CBCA, a shareholder who has held 1% of the outstanding voting shares or voting shares with a fair market value of at least CAD 2,000 for a period of at least six months, has the right to make his proposal to make, amend or repeal a by-law during the annual meeting.

- Corporate Veil Piercing: Under Canadian corporate law, the corporate veil can be pierced if the subsidiary is an agent for the parent, or the corporate form is being used for an improper and fraudulent purpose. As set forth by the Chevron Corp v Yaiguaje case, a Canadian court may impose liability directly on parent corporations in order to address the problem of corporations committing environmental damage.

- Disclosure of climate-related material information.
5.3 New Zealand

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| Company’s interest     | There is no definition of “company’s interest” in NZ corporate law, but it is possible to define it through the Financial Markets Authority (“FMA”) principles and the Company’s Act (“CA”). These principles state that the directors’ primary duty is the “best interest of the corporation”. (i) There are personal actions that can be carried out by the shareholders against the directors when they breach, among others, the: * Duty of care; * Duty to exercise powers for a proper purpose; * Duty to not agree to a company incurring certain obligations. (ii) | (i)FMA’s principles  
(ii)Company’s Act 1993 – Section 169                                      |
| Directors’ duty of care| Under NZ corporate law, directors and officers have two primaries statutory duties: a duty of care and a duty to act honestly and in good faith with a view to the best interests of the corporation. (ii) (iii) According to CA and FMA, the directors shall exercise the care, diligence and skill that a reasonable director would exercise in the same circumstances considering the nature of the company, the decision and the position of the director. (ii) Under the CA, the best interest of the corporation shall be pursued setting high standards of behavior, modelling it and holding the management accountable to deliver these standards throughout the organisation. (i) According to CA, a director, when is exercising powers or performing duties, must act in good faith and in what the director believes to be the best interests of the company. (i) | (i)Company’s Act 1993 – Section 169  
(ii)FMA’s principles  
| Board remuneration     | We did not detect any provision indicating the criteria that a company should follow for defining the directors’ remuneration.                                                                                                                                                                |                                                                      |
| Board composition      | According to New Zealand corporate law, there is only one board of directors in the companies. All directors have the same rights, powers and obligations, unless altered by the company’s constitution or shareholder agreement. (i)                                                                                       | (i)Company’s Act 1993                                                                                                    |
| Stakeholder involvement| We did not detect any stakeholder’s involvement in the designing of the sustainability strategy.                                                                                                                                                                                  |                                                                      |

77 The Companies Act 1993 defines "board of directors" as either:
1. The directors of the company, whose number is not less than the required quorum, acting together as a board of directors.
2. If the company has only one director, that director.
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<tr>
<td>Enforcement</td>
<td>We did not detect any enforcement relating to sustainability matters.</td>
<td>(i)NZX Code, ESG Guidance Note</td>
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<td>Reporting and disclosure</td>
<td>According to the NZX (“NZX”) Code, companies shall report relevant financial, environmental and social information.</td>
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<td>In 2017 the NZX published a guidance note which provided a resource to NZX issuers to understand the benefits of Environmental Social and Governance (“ESG”) reporting, providing information about global frameworks, and supporting the effective communication of ESG opportunities and risks to investors and stakeholders. The guidance notes also included information on green bonds that compliments transparent sustainability reporting, and supports the exchange’s commitment to collaborate and grow environmental and energy markets in NZ. (ii)</td>
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5.4 USA

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<td>Company’s interest</td>
<td>As highlighted by Dana Brakman Reiser in one of her recent studies and what provided by the Accountable Capitalism Act, directors have the duty to create a general public benefit and it is required to balance the pecuniary interests of shareholders with the interests of persons materially affected by the company, including employees, customers, communities, the local and global environment, short and long-term interests and ability to accomplish the general public benefit purpose. (i) (ii)</td>
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<td>Directors’ duty of care</td>
<td>The concept of “directors’ duty” is not defined by the United States corporate law, even if the case law (e.g. Smith v. Van Gorkom) uses to refer to it stating that the directors owe fiduciary duties of care and loyalty to the company and its shareholders. (i) (iv) Directors shall exercise the: • Duty of care which requires directors to act with the degree of care that an ordinarily prudent person in a like position would use under similar circumstances. The duty of care requires directors to act on an informed basis, after reasonable inquiry and deliberation. Directors are permitted to rely on management and experts where it is reasonable to do so; • Duty of loyalty which requires directors to act in good faith and in a manner the director reasonably believes to be in the best interests of the company and its shareholders. The (iv) Delaware Code lett. (e)</td>
<td>(i) Accountable Capitalism Act Section 5 (b) (1) (ii) Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985) and §102 b) (7) DGCL (iii) Accountable Capitalism Act Section 5 (b) (1) (iv) Delaware Code lett. (e)</td>
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Study on directors’ duties and sustainable corporate governance

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<td>duty of loyalty prohibits self-dealing and misappropriation of assets or opportunities and requires directors to keep information confidential. (ii)</td>
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<td>In Smith v. Van Gorkom(^78) the business judgment rule was a presumption that in making a business decision, the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company. Thus, the party attacking a board decision as uninformed must rebut the presumption that its business judgment was an informed one. (ii)</td>
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<td>A director must act &quot;in good faith, in a manner that he or she reasonably believes to be in the best interests of the corporation, and with the care that an ordinarily prudent person would reasonably be expected to exercise in a like position under similar circumstances&quot;.</td>
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<td>Under certain circumstances, directors can be held personally liable for violations of environmental and health and safety laws, including:</td>
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<td>• The Comprehensive Environmental Response;</td>
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<td>• Compensation and Liability Act;</td>
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<td>• Occupational Safety and Health Act;</td>
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<td>• Clean Air Act and Clean Water Act.</td>
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<td>Liability will vary depending on a director's knowledge or intent.</td>
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<td>Public Benefit Company (&quot;PBC&quot;) directors are given a special mandate: to &quot;balance&quot; the financial interests of shareholders, the interests of other stakeholders impacted by its conduct, and the public benefit it has selected.</td>
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**Estimations of sustainability risks and impacts**

We did not detect any provision indicating estimations of sustainability risks and impacts.

**Board remuneration**

We did not detect any provision indicating the criteria that a company should follow for defining the directors’ remuneration.

**Board composition**

According to the Delaware Code, US public companies predominantly have a unitary board structure. Besides, the NYSE and Nasdaq listing rules require that a majority of directors be independent. (i)

**Stakeholder involvement**

We did not detect any stakeholder’s involvement in the designing of the sustainability strategy.

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\(^78\) See link.
### Enforcement

Under US state corporate law, a shareholder can seek enforcement for breach of duties, such as fiduciary duty and harm, directors owe to their company through a derivative suit, meaning the shareholder will be suing on the corporation’s behalf. (i)

Directors of US companies are beneficiaries of a series of protective devices that insulate them from paying damages personally in a trial for breach of duty. This remedy is provided for the Delaware Code s.102(b)(7) authorizing companies to adopt an exculpatory provision protecting directors from personal liability in regarding only the duty of care. (ii)

The Delaware Code stated that a benefit corporation (iii) gives stockholders the right to enforce directors’ duty to consider the best interests of corporate constituencies and those affected by the corporation’s conduct when they make decisions. The right to sue to enforce the directors’ duties is only given to stockholders, and not to other corporate constituencies. (i) (iii)

### Reporting and disclosure

According to United States corporate law, it is common for companies to report on social, environmental and ethical issues (often referred to as Corporate Social Responsibility (“CSR”) issues). Indeed, directors are required to sign disclosure documents the company files with the Security Exchange Commission (“SEC”).

In 2018 shareholder proposals relating to environmental and social issues were the most prevalent proposal type for the third year in a row and a record number (12) achieved majority support. In 2018, 78% of S&P 500 companies issued a sustainability report, according to a report of the Investor Responsibility Research Center Institute (IRRCI). Besides, many companies also report on CSR matters voluntarily (for example, in 2018, 78% of S&P 500 companies issued a sustainability report, according to an IRRCI report).

79 Delaware’s Code, s. 102 (b) (7) does not permit a corporation to shield directors from liability for:
(1) breaches of their duty of loyalty;
(2) any acts or omissions done in bad faith or knowingly in violation of the law;
(3) unlawful payment of dividends or unlawful stock repurchases or redemptions; or
(4) transactions from which the director received improper personal benefit.

80 Under Section 362(a) of the Delaware statute, a “public benefit corporation” is a for-profit corporation intended to produce public benefit(s), to operate in a responsible and sustainable manner, and be managed in a way that balances the stockholders’ pecuniary interests, the best interests of those materially affected by the corporation’s conduct, and the public benefit(s) identified in its certificate of incorporation.
Environmental, social and governance (“ESG”) is no longer a fringe issue of interest only to special issue investors. Mainstream institutional investors are recognising that attention to ESG and CSR impacts portfolio company financial performance.

The Sustainability Accounting Standards Board (“SASB”) foundation, a non-profit that seeks to create industry sustainability standards for the disclosure and recognition of financially material environmental, social, and governance impacts of publicly traded US companies, is interested in solving the problem of making sustainability disclosures comparable.

In the USA the following relevant sustainable corporate governance initiatives could be identified in the Public Benefit Corporation (“PBC”): a PBC is a type of corporation that allow for public benefit to be a charter purpose in addition to the traditional corporate goal of maximizing profit for shareholders. PBCs are generally governed by boards of directors, which are appointed, rather than elected, and, internally, reflect bureaucratic forms. The corporation is government-owned and performs a specific, narrow function for the public good. Public benefit corporations of the federal government are often Independent agencies of the United States government as a form of government-owned corporation.

5.5 UK

There is no provision stated by UK corporate law which define the concept of “company’s interest”, but it is possible to detect the meaning through the Companies Act 2006 and CIC Regulations 2005.

For instance, the Companies Act 2006 stated that a director must act in the best interest of the corporation to promote its success considering:
- The consequences of decisions, including the long-term;
- The interests of the employees;
- The need to support business relationships with the suppliers and the customers;
- The impact of its operations on the community and environment;
- The company’s reputation for high standard of business conduct.

According to Art. 170 of the Companies Act 2006, directors of UK companies are subject to fiduciary and other duties owed to the company.

Directors ‘must exercise reasonable care, skill and diligence’, which is defined as ‘the care, skill and diligence that would be exercised by a reasonably diligent person with (a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company, and (b) the general knowledge, skill and experience that the director has’. (i)
### Area of analysis

<table>
<thead>
<tr>
<th>Description of the initiative</th>
<th>Source</th>
</tr>
</thead>
<tbody>
<tr>
<td>Directors owe duties to:</td>
<td></td>
</tr>
<tr>
<td>• Act within the powers conferred by the company's constitution;</td>
<td></td>
</tr>
<tr>
<td>• Promote the success of the company;</td>
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<tr>
<td>• Exercise independent judgement;</td>
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<tr>
<td>• Exercise reasonable care, skill and diligence;</td>
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<tr>
<td>• Avoid conflicts of interest;</td>
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<tr>
<td>• Not accept benefits from third parties;</td>
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<tr>
<td>• Declare interests in (proposed) transactions or arrangements.</td>
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<tr>
<td>Directors also owe a duty of confidentiality to the company, and the terms on which they are engaged by the company, especially in the case of executive directors, may impose or give rise to further duties and obligations.</td>
<td></td>
</tr>
<tr>
<td>Regarding the disclosure, directors of companies listed on the Main Market must comply with the Market Abuse Regulation's (&quot;MAR&quot;) requirements as to the public disclosure of inside information.</td>
<td></td>
</tr>
<tr>
<td><strong>Estimations of sustainability risks and impacts</strong></td>
<td><strong>We did not detect any provision indicating estimations of sustainability risks and impacts.</strong></td>
</tr>
<tr>
<td><strong>Board remuneration</strong></td>
<td><strong>We did not detect any provision indicating the criteria that a company should follow for fixing the directors’ remuneration.</strong> (i)</td>
</tr>
<tr>
<td><strong>Board composition</strong></td>
<td><strong>We did not detect any provision requiring to include individuals with specific expertise on sustainability in the board of directors, but regarding the CIC we have detected that a CIC limited by shares can have just one director, shareholder and at least two directors (trustees).</strong> (i)</td>
</tr>
<tr>
<td><strong>Stakeholder involvement</strong></td>
<td><strong>Although there is not a legislation providing for employee representation, the revised UK Corporate Governance Code recommends that companies choose between three methods to increase board representation and participation for employees: (1) appointing a director from the workforce; (2) establishing a formal workforce advisory panel; or (3) designating responsibilities to a non-executive director.</strong> (i)</td>
</tr>
<tr>
<td><strong>Enforcement</strong></td>
<td><strong>We did not detect enforcements that could be carried out by the interested parties.</strong></td>
</tr>
<tr>
<td><strong>Reporting and disclosure</strong></td>
<td><strong>According to the Companies Act 2006, is required for directors of private and public limited companies to disclose to the public certain information about the company (for example, the identity of the shareholders, names of directors, accounts and so on).</strong> (i) (ii)</td>
</tr>
</tbody>
</table>

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81 EU 596/2014; [link](#).
<table>
<thead>
<tr>
<th>Area of analysis</th>
<th>Description of the initiative</th>
<th>Source</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Some of this information is held on the public record at Companies House. Shareholders are also entitled to inspect records of general meetings, including all passed resolutions.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Besides, directors of AIM[^82] companies must, among other things, also give notification, without delay, of any new developments which are not public knowledge which, if made public, would be likely to lead to a significant movement in the price of its AIM securities. Extensive information must be disclosed to shareholders and, in many instances, is made public, through the financial reporting requirements of the Companies Act 2006. Regulated entities also must disclose certain information to the relevant regulatory body or bodies.</td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>To what regards the CICs, the CIC Regulations 2005 prescribe to disclose environmental, financial and social information.</strong></td>
<td></td>
</tr>
<tr>
<td></td>
<td>The minimum requirements provided by the CIC Regulations are:</td>
<td>(ii)Companies Act 2006.</td>
</tr>
<tr>
<td></td>
<td>• Details of what the CIC has done to benefit the company;</td>
<td>(iii)CIC Regulations 2005 - Section 26.</td>
</tr>
<tr>
<td></td>
<td>• Details of how it has consulted its stakeholders on its activities;</td>
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<td></td>
<td>• Details of dividends declared (or proposed) on shares and performance related interest paid and their compliance with the capping rules;</td>
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<tr>
<td></td>
<td>• Information on the transfer of assets to another locked body or otherwise at less than market value for the benefit of the community. (iii)</td>
<td></td>
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<tr>
<td></td>
<td>The Gender Pay Gap, the average difference between the remuneration for men and women who are working, stated that the reporting requirements apply to private- and voluntary-sector organisations with a headcount of 250 or more employees at 5 April 2019, and most public-sector organisations with 250 employees or more at 31 March 2019.</td>
<td></td>
</tr>
</tbody>
</table>

In the UK the following relevant sustainable corporate governance initiatives could be identified in the Community interest company ("CIC"): a CIC is a type of company designed for social enterprises that want to use their profits and assets for the public good. Schedule 1 of the Health and Social Care Act 2003 sets out the requirements for a CIC which include a membership made up of individuals living in a specific area, employees of the corporation and service

[^82] AIM is the London Stock Exchange’s international market for smaller growing companies.
users, and a board of governors some of whom are elected by the members on "constituencies" such as staff, users or public. A Cic must be a limited company and cannot:

- Be politically motivated;
- Be set up to serve unduly restrictive group;
- Be a charity;
- Carry out unlawful activities.

---

83According to Art. 6 – CIC Regulations 2005 are excluded the following companies:

(a) a company which is (or when formed would be) a political party;
(b) a company which is (or when formed would be) a political campaigning organisation; or
(c) a company which is (or when formed would be) a subsidiary of a political party or of a political campaigning organisation.
6 Analysis of best practices

This Annex includes an analysis of some practices related to the estimation of sustainability risks and impacts, board remuneration and stakeholder involvement.

As responses to the web-survey were limited, it was not possible to correlate current market practices with the economic proxies of short-termism, and therefore identify those practices that are more linked to long-termism. In this light, this analysis draws on practices that are considered particularly relevant and successful by the literature, and according to stakeholders that responded to the web-survey and participated in the case study interviews. These practices represented an additional input to the identification of the possible EU solutions to improve the current company law framework as presented in the core report in section 4.4.

6.1 Estimation of sustainability risks and impacts

With regard to the estimation of risks, there is evidence that many organisations find it challenging to integrate emerging ESG risks into existing risk management frameworks, and thus are exposed to a range of risks that are not being properly accounted for.\[64\]

In response to this challenge, the WBCSD collaborated with the Committee of Sponsoring Organisations of the Treadway Commission (COSO) and EY to develop a guidance to support businesses in applying ERM to ESG risks, published in 2018.\[65\] The guidance is designed to help risk management and sustainability practitioners apply enterprise risk management (ERM) concepts and processes to ESG-related risks. It is structured into five chapters (mirroring the five components of the COSO ERM Framework) and provides a list of actions for businesses to identify and manage current ESG-related risks and to respond to future challenges and megatrends (Figure 1). Relevant ESG risks will depend on the organisations and their specific business models and operations. This collaborative work on ERM-ESG alignment earned the UN ISAR Honours promoting sustainability in October 2019.

Figure 1 – COSO and WBCSD guidance for integrating ESG risks into companies’ ERM

<table>
<thead>
<tr>
<th>Chapter</th>
<th>Action</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td><strong>Governance and culture for ESG-related risks</strong></td>
</tr>
<tr>
<td></td>
<td>• Map or define the organisation’s mandatory or voluntary ESG-related requirements</td>
</tr>
<tr>
<td></td>
<td>• Consider opportunities for embedding ESG in the entity’s culture and core values</td>
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<td></td>
<td>• Be informed of the ways to increase board awareness of ESG-related risks</td>
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<tr>
<td></td>
<td>• Map the operating structures, risk owners for ESG-related risks, reporting lines and end-to-end ERM and strategic planning process to identify areas for improved oversight and collaboration</td>
</tr>
<tr>
<td></td>
<td>• Create opportunities for collaboration throughout the organisation</td>
</tr>
<tr>
<td></td>
<td>• Embed ESG-related skills, capabilities and knowledge in hiring and talent management to promote integration</td>
</tr>
<tr>
<td>2</td>
<td><strong>Strategy and objective-setting for ESG-related risks</strong></td>
</tr>
<tr>
<td></td>
<td>• Examine the value creation process and business model to understand impacts and dependencies on all capitals in the short, medium and long term. To assist with this understanding, conduct:</td>
</tr>
<tr>
<td></td>
<td>▪ Megatrend analysis to understand the impact of emerging issues in the external environment</td>
</tr>
<tr>
<td></td>
<td>▪ Strengths, weaknesses, opportunities and threats (SWOT) analysis</td>
</tr>
<tr>
<td></td>
<td>▪ Impact and dependency mapping for all types of capital</td>
</tr>
<tr>
<td></td>
<td>▪ An ESG materiality assessment to describe significant ESG issues</td>
</tr>
<tr>
<td></td>
<td>▪ Engagement with internal and external stakeholders to understand emerging ESG trends</td>
</tr>
<tr>
<td></td>
<td>▪ Analysis leveraging ESG-specific resources</td>
</tr>
</tbody>
</table>

\[64\] In 2017, WBCSD published a report, *Sustainability and enterprise risk management: the first step towards integration*, examining the state of integration of ESG-related risks and ERM. The report compared the sustainability and risk disclosures of 170 WBCSD member companies, and found that, on average, only 29% of the areas deemed to be material in a sustainability report were disclosed in a company’s legal risk filing. 35% of member companies did not disclose any of the sustainability risks identified in their sustainability reports in their legal filings. Discussions and surveys revealed that more than 70% of risk management and sustainability practitioners believed that “risk management practices [were] not adequately addressing sustainability risks”.

\[65\] WBCSD (2018), Enterprise Risk Management: Applying enterprise risk management to environmental, social and governance-related risks. Available at [link](link).
Throughout the risk management process, align with the entity’s strategy, objectives and risk appetite.

Consider the ESG-related risks that will impact the entity’s strategy or objectives.

Performance for ESG-related risks

3a Identifies risk
- Examine the entity’s risk inventory to determine which ESG-related risks have or have not been identified.
- Involve ESG risk owners and sustainability practitioners in the risk identification process to leverage subject-matter expertise.
- Convene meetings with both risk management and sustainability practitioners to understand ESG-related risks.
- Identify the ESG-related risks that may impact the organisation’s strategic and operational plans.
- Define the impact of ESG-related risks on the organisation precisely.
- Use root cause analysis to understand drivers of the risk.

Assesses and prioritizes risk

3b
- Understand the required output of the risk assessment (e.g., the impact in terms of the strategy and business objectives).
- Understand the entity’s criteria for prioritizing risks.
- Understand the metrics used by the entity for expressing risk (i.e., quantitative or qualitative).
- Select appropriate assessment approaches to measure risk severity.
- Select and document data, parameters and assumptions.
- Leverage subject-matter expertise to prioritise ESG-related risks.
- Identify and challenge organisational bias against ESG issues.

Implements risk responses

3c
- Select an appropriate risk response based on entity-specific factors (e.g., costs and benefits and risk appetite).
- Develop the business case for the response and obtain buy-in.
- Implement the risk response to manage the entity’s risk.
- Evaluate risk responses at the entity level to understand the overall impacts to the entity risk profile.

Review and revision for ESG-related risks

4
- Identify and assess internal and external changes that may substantively affect the strategy or business objectives.
- Review ERM activities to identify revisions to ERM processes and capabilities.
- Pursue improvements in how ESG-related risks are managed by ERM.

Information, communication and reporting for ESG-related risks

5
- Identify relevant information and communication channels for internal and external communication and reporting.
- Communicate and report relevant ESG-related risk information internally for decision-making.
- Communicate and report relevant ESG-related risk information externally to meet regulatory obligations and support stakeholder decision-making.
- Continuously identify opportunities for improving the quality of ESG-related data reported internally and externally.


As concerns the estimation of impacts, this activity falls under the ESG materiality assessment of the companies, i.e. the process whereby each company identifies the specific ESG issues that are relevant to its business, based on its industry, size, strategy, stakeholders, etc. This process typically encompasses a mix of peer benchmarking, megatrends analysis and engagement with internal and external stakeholders. Many frameworks, guidance and standards exist to support company’s ESG materiality assessment, the most important being illustrated in Table 1.

Table 1 – Main sources for ESG materiality assessment

<table>
<thead>
<tr>
<th>Frameworks, guidance and standards for ESG materiality assessment</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>AccountAbility AA1000 Five-Part Materiality Test</strong></td>
</tr>
</tbody>
</table>

Designed to help organisations identify (1) what issues are most material, or relevant, to their business and its stakeholders, and (2) what information should be disclosed or reported in sustainability and corporate social responsibility reports. The five-part materiality test covers:
Frameworks, guidance and standards for ESG materiality assessment

1. Direct short-term financial impacts: short-term financial impacts resulting from aspects of social and environmental performance
2. Policy-based performance: policies that are core to a business rather than add-ons
3. Business peer-based norms: issues that company peers deem to be important
4. Stakeholder behaviour and concerns: issues’ relevance to stakeholders in terms of reasonable evidence of likely impact on their own decisions and behaviour; and
5. Societal norms: considerations taken from both a regulatory and non-regulatory point of view.

Ceres Roadmap for Sustainability 2010

Resource to help companies re-engineer themselves for success in a world beset with unprecedented environmental and social challenges that threaten the economy and local communities. It is designed to guide companies towards corporate sustainability leadership, and ultimately support an accelerated transition toward a more sustainable global economy. The Ceres Roadmap contains 20 specific expectations for corporate sustainability leadership, divided into four areas of activity: governance, stakeholder engagement, disclosure and performance.

Global Reporting Initiative Standards (GRI)

GRI Standards are the first global standards for reporting publicly on a range of ESG impacts. Sustainability reporting based on the GRI Standards provides information about an organisation’s positive or negative contributions to sustainable development. The modular, interrelated GRI Standards are designed primarily to prepare a sustainability report focused on material topics. Preparing a report in accordance with the GRI Standards provides an inclusive picture of an organisation’s material topics, their related impacts, and how they are managed. An organisation can also use all or part of selected GRI Standards to report specific information.

Human rights due diligence

Human rights due diligence described by the UN Guiding Principles Reporting Framework is “an ongoing risk management process...to identify, prevent, mitigate and account for how [to address] adverse human rights impacts.” It includes four key steps: assessing actual and potential human rights impacts, integrating and acting on the findings, tracking responses and communicating about how impacts are addressed.

Integrated Reporting <IR> Framework

Framework for the preparation of an integrated report that combines the requirements of financial reporting with corporate sustainability reporting. The <IR> includes four basic steps to determining material information: identify relevant matters, evaluating importance, prioritizing important matters, and determining the information to disclose. It provides a process for identifying risks based on the legal, commercial, social, environmental and political contexts that affect the entity’s ability to create value in the short, medium and long term.

SASB standards Accounting Standards Board (SASB) Standards

SASB standards enable businesses around the world to identify, manage and communicate financially-material sustainability information to their investors. Although there is much ESG and sustainability information disclosed publicly, often it can be difficult to identify and assess which information is most useful for making financially-related decisions. SASB identifies financially material issues, which are the issues that are reasonably likely to impact the financial condition or operating performance of a company and therefore are most important to investors. SASB developed a complete set of globally applicable industry-specific standards which identify the minimal set of financially material sustainability topics and their associated metrics for the typical company in an industry.

Source: Authors’ elaboration based on WBCSD (2018), Enterprise Risk Management: Applying enterprise risk management to environmental, social and governance-related risks, p. 31.

Reducing negative ESG impacts requires companies not only to set targets, but also to ensure that these targets are in line with policy goals set by the policy makers and take account of the latest scientific scenarios. As regards climate impact reduction, the Science Based Targets initiative (SBTI), a joint effort of the Carbon Disclosure Project (CDP), the UN Global Compact, World Resources Institute and World Wildlife Fund, works with companies to set science based targets: GHG emissions reduction targets that are in line with what the latest climate science says is necessary to meet the goals of the Paris Agreement – to limit global warming to well-
below 2°C above pre-industrial levels and pursue efforts to limit warming to 1.5°C. SBTi overall aim is that by 2020, science-based target setting will become standard sustainability management practice, and companies will play a major role in driving down GHG emissions. The procedure to set science-based targets follows the steps below:

1. **Submit the commitment letter** to express company interest in working to set a science-based emission reduction target. Committed companies are publicly recognised on initiative-related websites;

2. **Develop a target** over a 24-month period. To be approved, the target must meet the SBTi’s target setting Criteria. Target validation criteria are regularly updated and the latest SBTi Criteria (4.0) offers companies two temperature goal options, 1.5 degrees and well-below 2 degrees;

3. **Submit the target for validation** by SBTi analysts;

4. **Upon validation, announce the target** and the company on Science Based Targets website and in other communications.

As of December 2019, **713 companies have committed to setting science-based targets.** Of these, 305 companies (including Ikea, Unilever, Kellogg, Walmart, Dell and Enel) have targets that have been approved by the SBTi experts.86

Other company-level practices concerning the identification of sustainability risks and impacts have been highlighted as best practices in the web-survey:87

- **Arcadis**, a global design, engineering and management consulting company based in the Netherlands, developed a connectivity matrix.88 This shows the company’s value creation process, from beginning to end. It also shows how Arcadis uses its strategic context to update its corporate strategy, covering its strategic pillars, corresponding risks, material topics, key performance indicators and targets, including sustainability.

- **Danone** performs a sustainability risks and opportunities mapping, to prioritise sustainability topics as part of the corporate risk identification and management processes.89 The methodology for this assessment is a four-step process: risks identification through a comprehensive documentary search, relying on work done for their materiality analysis, on benchmarks, on existing CSR reporting standards and existing internal risk assessment, which led to the identification of nine categories of risks, then the assessment of risks severity through work sessions with internal experts, with a mapping and a prioritisation according to the risk level and the likelihood of occurrence, then a consolidation of final risks mapping by selecting for each category the two to three main risks, and finally a validation by the sustainability governance of Danone, that is the Sustainability Integration Committee, the Social Responsibility Committee of the Board and the Audit Committee.

- **Schneider Electric**, the French energy company, performs regular assessments of the direct and indirect risks and opportunities linked to climate change challenges.90 To compile the list of the main sustainability risks, the company utilises both internal and external tools: a materiality matrix and an internal audit risk matrix internally, the key topics of the French Extra-Financial Performance Declaration, the UN Global Compact, the SDGs, non-financial rating agencies and specific requests form investors and consumers externally. The analysis covers the entire value chain of the company and its stakeholders: suppliers and subcontractors, transactions, customers, as well as cross-functional, environmental, social and societal topics, human rights and anti-corruption. Each topic is monitored by the

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86 The full list companies is available at this [link](#).
87 Q127 – Do you have any example to suggest of best practices of governance on the identification of sustainability risks and impacts?
relevant departments and their management, which are in charge of risk assessments and the implementation of mitigation and prevention actions. The main identified risks are then reviewed and validated by these departments, and by the Board of Directors’ secretariat, Internal Audit, and presented to the HR and CSR Committee and to the Sustainability Executive Committee. For each risk are then described the policies to mitigate them, the objectives, the performances on these objectives and the opportunities created with these actions. The risks identified in 2018 are circular economy and environmental regulations, climate, health and safety at work, recruitment and skills, gender equity, anti-corruption, human rights and duty of vigilance, and socially responsible investments.

6.2 Board remuneration

Linking the remuneration of board members to sustainability metrics – such as diversity and inclusion goals, energy efficiency targets, and GHG emissions reduction target – has the potential to increase accountability, reduce the risks related to sustainability underperformance, and create incentives to meet sustainability goals and achieve resultant benefits. Moreover, it also testifies the importance that achieving greater sustainability has for a company.

The G20/OECD Principles of Corporate Governance cover also the topic of board and executive remuneration. They call for the disclosure of remuneration of board members and key executives, and for providing shareholders with some form of say-on-pay. It is considered as good practice for boards to produce and disclose a remuneration policy statement, covering board members and key executives, to specify the relationship between remuneration and performance, and include measurable standards that emphasise the longer run interests of the company over short term considerations. The introduction of malus and claw-back provisions is also considered good practice. However, the G20/OECD Principles of Corporate Governance do not go as far as indicating as a best practice tying the remuneration of the members of the board and key executives to specific ESG metrics.

Similarly, according to the ICGN Global Governance Principles the remuneration should be designed to align the interests of the executives with the longer term interests of the company, linked to performance, disclosed in a clear understandable and comprehensive remuneration report, and approved by the shareholders. However, also ICGN Global Governance Principles do not single out the integration of ESG metrics into board members and executives remuneration as a good practice.

On this matter, in 2012, the PRI and Global Compact LEAD facilitated discussions between a diverse group of institutional investors and companies to explore the rationale, feasibility and effectiveness of including ESG factors in corporate executive pay plans to incentivise the delivery of long-term sustainable performance. The output was a guide for investors and companies on how to integrate ESG issues into executive pay, which resulted in a body of recommendations around three key areas: how to identify the appropriate ESG metrics for each company, how to connect these metrics to executive pay packages, and how to provide high-quality disclosure on remuneration practices. The 2012 recommendations are illustrated in Figure 2.
At **company level**, the following practices concerning board remuneration are highlighted as best practices by the available literature:

- **L’Oreal** considers sustainability objectives when it comes to determining the variable remuneration and performance targets of senior executives. Chairman and CEO Jean Paul Agon’s annual variable remuneration is based on hitting the organisation’s 2020 sustainability targets of a 60% decrease in carbon emissions, water consumption and waste. In 2016, the beauty products conglomerate announced it would start linking the bonuses of brand managers and country managers to environmental targets.  

- At **BNP Paribas**, remuneration is linked to the bank’s social commitments and integrates assessment criteria on sustainability. For example, the CEO’s variable remuneration in 2016 was linked to progress against 12 commitments outlined in their CSR policy, including contributions to achieving the UN SDGs. BNP Paribas has also developed nine indicators of sustainability performance which are used to determine the variable incentive plan for the 5,000 top managers, accounting for 20% of the eligibility conditions.

- **Xcel Energy**, the US electricity and natural gas utility, ties executive compensation to sustainability metrics. Public safety (15% weight of annual incentive) and employee safety (20% weight of annual incentive) were among the key performance indicators used in 2016 to determine the annual incentive for directors. The long-term incentives for executives also included performance shares targeted to deliver a 26% average reduction in CO2 emissions over a three-year period (30% weight of long-term incentives).

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91 CERES (2018), Systems rule: How Board governance can Drive sustainability Performance, p. 18
92 CERES (2018), Systems rule: How Board governance can Drive sustainability Performance, p. 19
93 CERES (2018), Systems rule: How Board governance can Drive sustainability Performance, p. 19
• **Alcoa**, the US corporation engaged in the mining and manufacture of raw aluminium, uses sustainability performance objectives to determine senior executive compensation. Cash and equity incentive programs are commonly used to motivate high-performing executives. 20% of Alcoa's annual cash incentive compensation plan for 2017 was based on sustainability goals, including safety targets (5%), CO2 emission reductions (5%) and diversity (10%). The diversity goals include specific targets for employing executive-level and professional-level women and minorities.\(^{94}\)

Other best practices have been signalled through the web-survey:\(^{95}\)

• At **DSM**, the Dutch multinational active in the fields of health, nutrition and materials, the variable income part of remuneration consists of short-term and long-term Incentives, each consisting of 50% of the base salary.\(^{96}\) Half of the short-term incentives are then related to financial targets, and the other half to sustainability and individual targets. Among the sustainability targets there are a safety performance, an employee engagement index and the percentage of portfolio made of products and services that offer an environmental and/or a social benefit (called Brighter Living Solutions), following internal or external standards (such as WBCSD Chemical Sector\(^{97}\) approach). Part of these short-term incentives (25% mandatory that can go up to 50% with a voluntary portion) has a three-year vesting period. Long-term incentives have a three-year vesting period and are linked to four performance measures: relative total shareholder return, return on capital employed growth, energy efficiency improvement and greenhouse gas emissions efficiency improvement.

### 6.3 Stakeholder involvement

Stakeholder involvement in decision-making is key to strengthen the business relationship with its workforce and the society in which it operates, and consequently to promote its long-term success to the benefit of stakeholders and shareholders alike. Recent research\(^{98}\) suggest that there is a strong business case for stakeholder engagement, as this practice allows companies to (1) protect license to operate by building reputation and credibility, (2) anticipate emerging risk by understanding stakeholder concerns, and (3) improve problem-solving and decision-making by hearing a diverse range of perspectives and expertise.

The **G20/OECD Principles of Corporate Governance**\(^{99}\) lay down general principles concerning the role of stakeholders in corporate governance. It is maintained that that the corporate governance framework should recognise the interests of stakeholders and their contribution to the long-term success of the corporation. In particular, the Principles recognise the importance for companies to recognise the rights of stakeholders established by the law or mutual agreement, to enable stakeholders to communicate and obtain redress for the violation of their rights, and, most importantly, to set up mechanisms for employee participation in corporate governance (e.g. employee representation on boards, works councils that consider employee viewpoints in certain key decisions). The establishment of a whistle-blowing system for employees is also identified as a good practice.

The **OECD Guidelines for Multinational Enterprises**\(^{100}\) provide that enterprises should engage with relevant stakeholders to provide meaningful opportunities for their views to be taken into account in relation to planning and decision-making for projects and activities (such as the intensive use of land or water) that might significantly impact local communities. The

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\(^{94}\) CERES website [link].

\(^{95}\) Q126 – Do you have any example to suggest of best practices of directors’ remuneration incentivising a focus on innovation and long-term performance?

\(^{96}\) See the Remuneration policy Managing Board of DSM Integrated Annual Report 2018, available at the following [link].


\(^{98}\) SustainAbility (2018), Common Threads: Designing Impactful Engagement.


\(^{100}\) OECD (2011), OECD Guidelines for Multinational Enterprises, OECD Publishing. Available at [link].
Guidelines promote consultation and cooperation between employers and employees; disclosure of information on material issues regarding employees and other stakeholders; and adequate and timely communication and consultation with the communities directly affected by the environmental, health, and safety policies of the enterprise and by their implementation. Meaningful stakeholder engagement (to identify actual or potential adverse impacts, devise prevention and mitigation responses to risks, identify forms of remedy for adverse impacts caused or contributed to by the enterprise and when designing processes to enable remediation, etc.) is also recognised as important in the OECD Due Diligence Guidance for Responsible Business Conduct.\(^{101}\)

Stakeholder Engagement and the Board: Integrating Best Governance Practices,\(^{102}\) a 2009 publication developed in the context of the Global Corporate Governance Forum, provides more detailed guidance on stakeholder engagement at board level. Specifically, Figure 3 illustrates the key steps for the boards to embed stakeholder involvement in company’s governance.

Figure 3 – Key steps to embed stakeholder engagement in the company’s governance

1. Define stakeholder engagement as a core value
2. Identify, discuss and prioritize key risks associated with changing societal expectations
3. Determine the board’s financial and nonfinancial information needs for decision-making, management oversight, and monitoring key stakeholder relationships associated with generating value and wealth.
4. Discuss and approve key performance indicators for social, environmental, and financial performance
5. Approve a policy for external reporting
6. Integrate stakeholder issues into annual general meetings of shareowners
7. Discuss the risks and impacts of projects and operations and provide transparent disclosure information to shareowners and other key stakeholder groups
8. Convene stakeholder forums and invite key stakeholder representatives to address board meetings

Source: IFC (2009), Stakeholder Engagement and the Board: Integrating Best Governance Practices, Global Corporate Governance Forum Focus 8, pp. 16-17.

The same publication suggests including in the governance structure some mechanism by which stakeholder views can feed directly into the corporate decision-making and by which stakeholders can hold the management accountable, such an advisory board (particularly where stakeholder representation in the board is not mandated by the law). Moreover, companies can ensure greater involvement of stakeholders in their non-financial reporting process by establishing independent advisory committees or stakeholder panels, acting as a proxy of different stakeholder groups, to allow them to review company’s approach to assessing and reporting on social and environmental performance related to corporate activities. These committees or panel might be chaired by a non-executive director and should be given direct access to the board, in order to ensure that the board gets a broad sense of outside perspectives of the company.


\(^{102}\) IFC (2009), Stakeholder Engagement and the Board: Integrating Best Governance Practices, Global Corporate Governance Forum Focus 8.
On the same matter, in 2017 the ICSA (now known as Chartered Governance Institute) and the Investment Association (IA) published *The Stakeholder Voice in Board Decision Making*, a guidance document which is aimed at helping UK company boards to ensure they understand and weigh up the interests of their key stakeholders when taking strategic decision. The publication identifies 10 core principles that should guide stakeholder engagement at board level, as illustrated in the Figure 4.

**Figure 4 – ICSA and IA core principles for stakeholder engagement at board level**

1. Boards should identify, and keep under regular review, who they consider their key stakeholders to be and why.
2. Boards should determine which stakeholders they need to engage with directly, as opposed to relying solely on information from management.
3. When evaluating their composition and effectiveness, boards should identify what stakeholder expertise is needed in the boardroom and decide whether they have, or would benefit from, directors with directly relevant experience or understanding.
4. When recruiting any director, the nomination committee should take the stakeholder perspective into account when deciding on the recruitment process and the selection criteria.
5. The chairman – supported by the company secretary – should keep under review the adequacy of the training received by all directors on stakeholder-related matters, and the induction received by new directors, particularly those without previous board experience.
6. The chairman – supported by the board, management and the company secretary – should determine how best to ensure that the board’s decision-making processes give sufficient consideration to key stakeholders.
7. Boards should ensure that appropriate engagement with key stakeholders is taking place and that this is kept under regular review.
8. In designing engagement mechanisms, companies should consider what would be most effective and convenient for the stakeholders, not just the company.
9. The board should report to its shareholders on how it has taken the impact on key stakeholders into account when making decisions.
10. The board should provide feedback to those stakeholders with whom it has engaged, which should be tailored to the different stakeholder groups.


More recently, also the international think tank SustainAbility put forward a number of best practices to maximise the impact and the business value of (external) stakeholder engagement, based on empirical research. The involvement of the boards of directors into external stakeholder engagement activity is singled out as company leading practice. In particular, the following good practices are included in the 2018 report *Common Threads*:

- **A cohesive approach.** Leading companies benefit from company-wide strategies to guide engagement across their operations;
- **Corporate-level reporting on activities.** Best practice involves clearly communicating the company’s approach to engagement, who are its stakeholders, and what are their key concerns as well as the company’s response. Stakeholders expect transparency on the outcomes and impacts of the engagement;
- **Involvement in sector-level initiatives.** Participation in industry collaborations that draw on external expertise is perceived as both necessary and as the best means to attempt systemic change. The Sustainable Apparel Coalition (a global alliance of apparel, footwear and textile industry for sustainable production) is an example of new industry collaboration. Traditional business associations can also present important collective engagement opportunities with government and other stakeholders;
- **Starting or joining dialogues on specific material topics.** Leading companies are engaged in more focused discussion with their stakeholders on material issues. For example, the multi-stakeholder Roundtable for Sustainable Palm Oil seeks to address the complex social and environmental impacts of palm oil. Leading companies are coming to

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104 SustainAbility (2018), *Common Threads*, pp. 41-42.
the table in these engagements to understand what their stakeholders expect of them on those topics and work together on solutions;

- **Engagement of the board of directors.** Involvement of the board in stakeholder engagement is an indicator of company commitment. Bringing a summary of external stakeholder concerns to the board on regular basis, along with an explanation of company responses, should be regarded as a starting point. Further steps would be to ask for board input to engagement (e.g. on particularly challenging topics that are unresolved) and to enable external stakeholders to directly meet with the board.

- **Operation of an external stakeholder council.** Some leading companies have established an external group of experts from a range of stakeholder categories to provide regular feedback on topics such as company and sustainability strategy, goals and communications.

Despite being focused on external stakeholders, the report also points out that leading businesses are increasingly recognising the value of engaging employees on the company’s purpose and its material issues.105

At **company level**, based on case studies presented in the SustainAbility report, the following can be highlighted best practices of external stakeholder engagement, even at board level:

- **Telefonica**, the global telecommunications company, features a highly structured strategy for engaging stakeholders at a corporate level. At board level, the Public Affairs and Regulation Committee provides institutional oversight and guidance on stakeholder engagement. The company convenes a Responsible Business Central Panel, composed of experts representing the organisation’s main stakeholders (suppliers, customers, investors, NGOs, multisector organisations) and from the professional services field. The panel meets quarterly for in-depth discussions, chaired by an independent third party. It also gives critical input into the company’s materiality assessments. In addition, the company has created a Responsible Business Extended Panel, involving more than 400 organisations that help to assess Telefonica performance and inform the company of their expectations regarding issues in their specific operating markets.106

- **BASF**, the German chemicals company, has established in 2013 an independent external Stakeholder Advisory Council, composed of various renowned thinkers and leaders, which meets annually with the board of directors to evaluate critically and refine the sustainability management of BASF. In the meetings, issues such as such as corporate strategy and targets, responsibility in the supply chain, climate change, human rights, the impact of externalities or the challenge of renewable raw materials are discussed. Based on recommendations of the Stakeholder Advisory Council, BASF reviews and update its sustainability approach and positioning. BASF also runs Community Advisory Panels, i.e. discussion fora for open dialog, mostly used at larger production sites, that involve individuals who live near or around chemical facilities and who represent the fabric of local communities.107

Other examples of best practices were suggested in the responses to the web-survey:108

- Many respondents mentioned the practice of having stakeholder dialogues that lead to the publication of a materiality matrix, composed of issues material to the company and the stakeholders. One best practice in this field is considered **TKH Group**, a Dutch technology company, which in 2018 organised dialogues with eight categories of stakeholders.109

Another one is **Unilever**, which carry out a materiality assessment every two years, within

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106 SustainAbility (2018), *Common Threads*, p. 49. Information double checked on Telefonica website. ([link](#)).
107 SustainAbility (2018), *Common Threads*, p. 50. Information double checked on BASF website. ([link](#)).
108 Q129 – Do you have any example to suggest of best practices of corporate governance to involve stakeholders into corporate decision-making?
which stakeholders are engaged through a series of interviews, both external stakeholders and employees.\textsuperscript{110}

- **Carrefour** set up in September 2018 a Food Advisory Committee made up of recognised experts in eating well, health and sustainable agriculture, as well as stakeholders (e.g. a farmer and a chef), to contribute to the accomplishment of the company’s mission.\textsuperscript{111}

- **SSAB**, a Swedish-Finnish steel company, identifies six important stakeholder groups, for which developed engagement practices following the GRI 102 standard on general disclosures,\textsuperscript{112} collecting their concerns and expectations, for which specific response actions are provided.\textsuperscript{113}

- **Suez**, the French utility company, has also built a stakeholders committee that is consulted every year under the moderation of a third-party guarantor (Imagin’able in 2018) to challenge its strategy and performance.\textsuperscript{114} Moreover, the company has contributed to the launch of sharing platforms and common standards, such as the OECD Principles on Water Governance.

\textsuperscript{110} Unilever (2019), ‘Sustainable Living Report 2018 – Defining our material issues’, available at this link.  
\textsuperscript{111} Carrefour (2019), ‘2018 Activity Report’, p. 6, available at this link.  
\textsuperscript{112} GRI (2016), ‘GRI 102: General Disclosures – 43 Approach to stakeholder engagement’.  
\textsuperscript{113} SSAB website, section Stakeholders, available at this link.  
\textsuperscript{114} Suez website, section Dialogue with stakeholders, available at this link.
7 Detailed evidence on factors contributing to corporate short-termism

This Annex provides detailed evidence on a number of factors, generally considered by academics and experts as root causes of short termism:

- Directors’ duties and company’s interest;
- Pressure from investors;
- Sustainability strategy and estimation of sustainability risks and impacts;
- Board remuneration;
- Board composition;
- Stakeholder involvement;
- Enforcement;
- Non-financial reporting and disclosure.

7.1 Directors’ duties and company’s interest

7.1.1 Evidence from the literature

The literature review highlighted one factor that contributes to short-termism in corporate decision-making: the definition and interpretation of directors’ duties and “company’s interest”.

**Definition and interpretation of directors’ duties and “company’s interest”**

How does this factor relate to short-termism?

In every jurisdiction across the world, including EU countries, directors’ duties are owed primarily to the company (i.e. to the legal entity), and not to the shareholders of that entity. This basic principle is universally accepted and undisputed.\(^1\) The core duty of the board is to protect and promote the interests of the company. The concept of “company’s interest” is at the core of corporate governance, as it informs directors’ duties and shapes the role and behaviour of directors in corporate decision-making.\(^2\) The key problem is that there is not a uniform understanding of this concept, as the concept of the interests of the company has traditionally been viewed differently across jurisdictions, and the academic and practitioners’ debate has been long and characterised by polarised positions.

The position that has come to prevail in corporate governance practice is the one supporting the “shareholder primacy” norm.\(^3\) According to the shareholder primacy norm, the purpose of a company is to maximise the shareholder value, and its interest is to increase profits to the benefit of shareholders. This view implies that directors and executives act as “agents” of the shareholders, and should use resources primarily for the benefit of their “principal” (i.e. the shareholders). The idea behind the shareholder primacy is that, left to their own, agents would pursue their own interests.\(^4\) Further according to the shareholder primacy norm, directors owe fiduciary duties only to shareholders, to whose benefit they must manage the business. Protection of other interests is beyond their duties, except in those situations where they are contractually compelled to do so. Actions to promote the interests of stakeholders other than shareholders are regarded as a way for directors and executives to promote their

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3. The term primacy is not always used in the literature and this idea is expressed in various ways, such as shareholder sovereignty or shareholder value, but, for sake of clarity, we will adopt shareholder primacy, using shareholder value only when it refers to a legal requirement expressly present in legislations such as the UK’s one.
own strength and prestige, and to expropriate shareholders of their resources. Shareholder primacy is reinforced by the accountability of directors towards shareholders and by the fact that shareholders have instruments to orient directors' decisions towards short-term outcomes. These instruments include, for instance, shaping the remuneration schemes of the executives based on their short-term performance, and the possibility to remove executives from office if they do not meet investor expectations. Moreover, as highlighted in section 8.7, shareholders are the only constituency having enforceable rights, which gives them substantial influence over the board.

The prominence of the shareholder primacy norm in business and policy-making circles – especially in the US but in Europe as well – has a strong influence over several aspects of corporate governance and company law, and, as discussed in the sections below, it is identified in several multijurisdictional studies as the main obstacle to the pursuit of sustainability objectives by companies, driving directors and managers to focus on short-term financial results rather than long-term objectives.

In the words of Sjåfjell and Anker-Sørensen, "shareholder primacy’s short-term and narrow effect prevents full realisation of companies’ potential to be part of the solution even to the extent that companies do not see the business case and the potential that lies in being market leaders in social and environmental terms". The shareholder primacy "creates an environment where a corporate decision may cause harm and allows the harmful conduct to go unpunished. Since directors [are perceived as only owing] a legal duty to shareholders, directors may regard external interests as irrelevant in their decision making". In the current situation, even if directors do take into account the interests of stakeholders other than shareholders, that is voluntary and usually driven by a desire to promote or protect shareholders’ interests. This is problematic because, while stakeholder interests may materialise in the longer term, shareholder interests are generally more focused on the short term.

Moreover, it is maintained that, in absence of a clear duty to identify and mitigate long-term economic, social and environmental risks and impacts, and due to the pressure from market expectations and investors, directors tend to focus primarily on short-term financial performance and risks, and do not anticipate the materialisation of systemic long-term risks and their impacts, including at environmental and social level. Shareholder primacy lies behind remuneration practices that reward executives’ focus on company’s short-term results and increase the share price. Since (variable) remuneration is often linked to the achievement of short-term indicators (such as annual or even quarterly performance metrics), executives are incentivised to pay more attention to performance indicators and to undertake

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120 EY (2014), Short-termism in Business: Causes, Mechanisms and Consequences, EY Poland. Available at (link).
risky decisions that can boost revenues in the short term, regardless longer-term value creation and sustainability considerations. “As the trustees of the corporation, directors too often focus on issues that are only material for short-term financial performance. […] Because shareholder primacy ideology has been widely perceived as a legal requirement, directors by and large have not seriously considered the full array of potential audiences that may be significant”. 129

Supporting evidence

Directors’ duties define how directors perform their responsibilities, i.e. to whom the directors are accountable and what directors are accountable for in carrying out their role. 130 The definition of directors’ duties is therefore crucial to ensure that, in performing their responsibilities, directors identify and address environmental, social and economic risks and external impacts in business operations and value chain, and promote the long-term sustainability of a company. The material content of directors’ duties is expressed into two basic duties: 131

- The duty of care requires board members to devote sufficient time, care, and diligence to managing the company, establish information and monitoring systems, supervise business operations, and possess the necessary skills and experience to discharge their functions effectively. It addresses the perceived agency problems 132 by constraining managerial discretion and protecting the interests of the shareholders and other stakeholders. 133 The duty of care is broadly recognised in the company law of all EU Member States, 134 however in no EU Member State the formulation explicitly encompasses a duty for board members to identify and mitigate the economic, social and environmental factors that affect the long-term life of the company, both internally (i.e. sustainability risks to the company) and externally (i.e. the contribution of the company to sustainability as a global overarching goal, as expressed in the SDGs).

- The duty of loyalty requires board members to subordinate their personal interests to those of the company and applies in particular when the director has a material (financial) interest in a transaction at odds with the interests with the company. It addresses conflicts of interests between the directors and the company. 135

Even though there are slight differences in how directors’ duties are defined across jurisdictions, these mainly relate to nuances. The core duty of the board is to protect and promote the interest of the company, and not the one of shareholders or any other third party. 136 The question of the interests of the company is therefore the common denominator in the discussion of the role of the board across jurisdictions. The interest of the company is important because, in legal terms, it gives content to the core duty of the board, limiting the discretion of the board and shaping role of the directors in managing the company’s business. 137

The concept of the interests of the company has traditionally been defined and viewed quite differently in the various jurisdictions, 138 spanning across a spectrum running

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between “pluralism” and “monism”. According to the literature, pluralism relates to jurisdictions where a broader set of interests are encompassed by the notion of “company’s interest”, while monism equates the interests of the company with the interests of the shareholders. A pluralist approach to the interests of the company either requires the board, or gives it discretion, to balance a variety of interests, independent of the effect of this on shareholders, while the monistic approach gives priority to the shareholders’ interest, with the board of directors given discretion to take into account other interests only in so far as they are expected to increase returns to shareholders. Figure 5 shows a positioning of the EU Member States along this spectrum.

![Figure 5 - EU Member States approaches to “company’s interest”](image)

**Source:** Authors’ elaboration based on Gerner-Beuerle, C., Paech, P., Schuster, E.P. (2013), ‘Study on directors’ duties and liabilities’, LSE.

In several European jurisdictions there is no codified definition of the interest of the company, nor detailed guidance on how to interpret the interest of the company. This implies that deciding what it means to act in the company’s interest is left to a large extent to the subjective business judgement of directors, which can be influenced by cultural and social norms. The room left by the wide discretion afforded by the law has been filled by the social norm of shareholder primacy and progressively brought directors to assimilate the interest of the company to maximising returns for shareholders. The social norm of shareholder primacy provides that the board of directors and senior managers are the ‘agents’ of the shareholders and should maximise returns to shareholders as measured by the current share price.

Even though national jurisdictions following a pluralist approach seem to favour a more “open” approach where the company’s interest is understood as encompassing also the interests of other stakeholders besides shareholders, due to the strength of the shareholder primacy drive, the interpretation of laws and codes often tends in practice to prioritise returns for

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141 Meaning that there is not a definition codified in statutory law, for instance in BE, CY, EE, HU, IE, IT, LV, NL, RO. Gerner-Beuerle, C., Paech, P., Schuster, E.P. (2013), cit., p. 66.
shareholders’ interests, and in particular to maximise those returns. For instance, in the Nordic countries, the formulation of the company interest in practice is considered as moving from a pluralist, continental European position towards a conception of the company interest that is much closer to the shareholder value approach taken by common law jurisdictions. Eventually, the shareholder primacy norm justifies short-term decisions also in countries where the approach is less shareholder-centric. In this scenario, social and environmental concerns are only taken into consideration by the boards at most where there is a strong business case to do so.

Among the main drivers to this interpretation there is the fact that shareholder primacy is wrongfully perceived as a legal duty of the board. The reason is that the concept of shareholder primacy is often confused with acting for the collective benefit of the company’s shareholders – which is a legal norm in some Member States.

The legal requirement for boards to prioritise shareholders’ interest that characterises monistic jurisdictions should thus not be confused with the social norm of shareholder primacy. The shareholder primacy is not a legal provision originating in company law, but rather a social and cultural norm emerging from the norms and practices surrounding the rise of the hostile takeover movement in the Britain and America in the 1970s and 1980s. Over the last forty years, the shareholder primacy has been increasingly adopted in business and policy making circles – especially in the US and has become a preeminent corporate governance narrative also outside US. Nonetheless, multijurisdictional research shows that no corporate law system insists on boards focusing only on returns for shareholders, and for these returns to be maximised, even in jurisdictions where profit for shareholders is emphasised. For instance, under UK law, directors are explicitly mandated to promote the success of the company for the benefit of its members (shareholders) whilst having regard to various wider concerns, and the duty is owed to the company rather than to the shareholders directly (for the concept of “enlightened” shareholder value, see Box 1).

**Box 1 – “Enlightened” shareholder value in the UK**

In the UK, duties are owed to the company, but the law requires the shareholders’ interests to be paramount in board decision making. This holds true even after the adoption of the “enlightened shareholder value” approach set out in section 172 of the Companies Act 2006, which states that a director must “act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members (i.e. the shareholders) as a whole.” In performing their responsibilities, directors must consider various other stakeholder groups, as well as environmental issues and long-term consequences for the company, but ultimately these things are relevant only to

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148 Millon, D. (2013), ‘Radical Shareholder Primacy’, *University of St. Thomas Law Journal*, Vol. 10. Millon, in this article, distinguishes between radical shareholder primacy, as the social norm, and traditional shareholder primacy, the legal norm, in a similar way as later work distinguishes between shareholder primacy as the social norm and shareholder value as the legal norm, see Sjåfjell B., Johnston, A., Anker-Sørensen, L., Millon, D. (2015), cit., pp. 79-147.
151 For instance, it is argued that the Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement was adopted to strengthen the rights of the shareholders, in accordance with the shareholder primacy model (Source: Johnston, A., Morrow P. (2018), ‘The revised Shareholder Rights Directive 2017: Policy Implications for Workers’, ETUI Policy Brief, European Economic, Employment and Social Policy, No. 2/2018, p. 1).
153 The rationale behind enlightened shareholder value is that, in the long run, the interests of shareholders converge with those of other stakeholders and, even more importantly, those of the company itself. Therefore, requiring directors to promote the interests of shareholders will, in the long run, be good for other stakeholders and for company performance. See Deva, S. (2011), cit., pp. 76-102.
the extent they impact shareholders’ interests. This is problematic because, while stakeholder interests may materialise in the longer term, shareholder interests are generally more focused on the short term.

Source: Authors’ elaboration based on referenced sources

It is argued that, due to the prevalence of shareholder primacy, the long-term interests of stakeholders other than shareholders (such as employees, creditors, suppliers, customers and the society at large as well as the environment) are largely ignored in the current corporate governance theory and prevailing practice. The shareholder primacy drive creates pressures “on corporate managers to pursue the goal of profit maximisation with total disregard for the interests of stakeholders other than shareholders”, in spite of the preeminent role played by stakeholders in a company’s long-term success. Due to these pressures, corporate boards fail to take (sufficient) account of stakeholder interests and consequently to internalise their point of view in business decision-making, with negative consequences for corporate long-term sustainability.

However, striking the balance between different groups of stakeholders is essential to the long-term success of the company. As pointed out by Kaplan and Norton in their seminal empirical research on performance measurement in companies, fair and balanced stakeholder’s perspective results in long-term shareholder value maximisation. In today rapidly changing environment, the board’s ability to consider other stakeholder interests should be a key component of both corporate risk management and strategic planning. This implies that, when a board is focusing exclusively on short-term shareholder value, it is doing a disservice not only to employees, customers and other stakeholders, but also to shareholders and the corporation as a whole. In considering and balancing the perspectives and interests of shareholders and other stakeholders, the directors benefit also the long-term interest of the shareholders (e.g. increasingly consumers prefer to buy products from companies they trust; suppliers are interested in business partnerships with companies they can rely on; employees rather work for companies they respect; large investment funds favour socially responsible firms; and most respected NGOs prefer to cooperate with companies conciliating their investment interests with community or even goals, such as the SDGs). In short, successful stakeholder engagement and involvement is important for corporate sustainability, although it should be acknowledged that larger stakeholder engagement by itself cannot be equated to corporate sustainability.

Support of internal and external stakeholders is key to the company’s long-term business success. As shown by the body of literature on the “social license to operate”, the long-term success of a corporation depends critically on establishing and maintaining good relations with various stakeholder constituencies with a legitimate interest in its operations, such as employees, creditors, suppliers, local communities, and the society at large. A business is

granted a “social licence” when its organisational values, operations and processes meet stakeholder expectations and satisfy societal norms.\textsuperscript{161} The perceived business advantages of a social licence include improved corporate reputation, ongoing access to resources, reduced regulation, improved market competitiveness, strengthened stakeholder relationships and positive effects on employees.\textsuperscript{162} A business strategy that fails to consider sustainability issues and to take account of the interests of a broad range of stakeholders (and even thrives at their expense), may rapidly undermine a corporation’s social license.\textsuperscript{163} Losing a social license will result in difficulties for the business to operate (e.g. increased regulation, reduced market access, reduced competitiveness, etc.) and increased pressure from stakeholder groups whose interests are disregarded. Moreover, companies that neglect the interests of stakeholders other than shareholders fail to internalise in their business decisions the valuable point of view of stakeholder constituencies with a longer-term perspective, notably employees. As argued by Johnston and Morrow, “employees make illiquid, non-diversifiable investments in the companies for which they work, and so have a longer-term perspective than many shareholders. If policy-makers were to allow them to express that perspective in corporate governance processes, the problem of short-termism would be significantly reduced.”\textsuperscript{164}

As a consequence of the trend that directors interpret company’s interest and shareholder value maximisation and consequently their duties as owned to the shareholders, considerations around sustainability risks and impacts for the companies tend to be moved to the background. There is indeed evidence that boards are engaged in sustainability matters only to a limited extent. A 2014 UN Environment Programme Finance Initiative study of 60,000 businesses found that only 2\% of companies that report on Environmental, Social and Governance (ESG) information had a director with responsibility for sustainability.\textsuperscript{165} Only 374 companies had a sustainability committee that reported directly to the board, and none of those committees included board members. Although the lack of a director or a sustainability committee specifically entrusted with dealing with sustainability does not imply that the board of directors as whole is not paying attention to sustainability matters, it might nonetheless be seen as possible indication of the (limited) extent of attention being paid by the board to sustainability vis-à-vis other topics. The 2015 “Joining Forces: Collaboration and Leadership for Sustainability” report\textsuperscript{166} found that 86\% of surveyed executives agreed that boards of directors should play a strong role in driving their company’s sustainability efforts, but only 42\% of boards were perceived to be at least moderately engaged with the company’s sustainability initiatives, indicating a gap in board engagement with sustainability matters. Similarly, in the 2016 “Investing for a Sustainable Future” report\textsuperscript{167} 86\% of surveyed investors agreed that company boards should play a strong role in their company’s sustainability efforts, but only 48\% said that company CEOs were actually engaged, and just 30\% agreed that the sustainability efforts of companies had strong board-level oversight.

Despite its widespread development, the shareholder primacy norm and the idea of prioritising shareholders’ interests have come under growing criticism,\textsuperscript{168} especially after the financial crisis of 2008.\textsuperscript{169} Both at academic and industry level, many rejected the
position that the general purpose of the company is to pursue the maximisation of shareholders value, arguing, among others, that the conception of corporate governance as an ‘agency problem’, and as a question of investor protection is overly simplistic.\textsuperscript{170} It is also argued that despite some positive advancements in terms of Corporate Social Responsibility (CSR), the shareholder primacy creates pressure on executives to ignore ESG factors and systemic risks,\textsuperscript{171} and that business as usual is not sufficient to tackle the increasingly important sustainability issue our society faces.\textsuperscript{172} This criticism is reflected in a number of initiatives launched by both academics and industry representatives in the US and Europe that aim at bringing sustainability objectives in the boards’ decision-making processes (Box 2).

**Box 2 - Initiatives and projects on sustainability and corporate governance**

Among the ongoing or concluded initiatives analysing the interaction between company law, corporate governance and sustainability, there are:

- The Sustainable Companies Project,\textsuperscript{173} led by Prof. Beate Sjåfjell of the University of Oslo, was launched in 2010 with the aim of understanding how to integrate environmental concerns better into the decision-making in companies, and was concluded in 2013, and led to the publication of a number of books and articles;
- Another project from the University of Oslo and coordinated by Prof. Sjåfjell is the H2020-funded Sustainable Market Actors for Responsible Trade (SMART),\textsuperscript{174} analysing several factor influencing the sustainability of businesses and other market actors, among which corporate governance issues;
- The Modern Corporation Project,\textsuperscript{175} directed by Dr. Jeroen Veldman from Nyenrode Business University and Prof. Hugh Willmott from Cass Business School, is a research project on corporate governance theory and practice started in 2013, and among its outputs it released a Statement on Company Law, signed by a number of academics, which addresses common errors in the way company law concepts are understood and applied at board level (with consequences on long-term value creation);\textsuperscript{176}
- The Purpose of the Corporation Project,\textsuperscript{177} an initiative on the non-profit law firm Frank Bold, organised a series of roundtables of academic and business representatives to discuss the promotion of the long-term health and sustainability of listed companies;
- The Future of the Corporation by The British Academy,\textsuperscript{178} a research and public engagement programme examining the purpose of business and its role in society, led by Professor Colin Mayer and started in 2017, leading to a first report concluded that a shift is needed away from the dominant notion that business should be primarily focused on maximising returns to shareholders,\textsuperscript{179} and then to a second report proposing some Principles for Purposeful Business,\textsuperscript{180} which will be discussed in a series of summits.

Other initiatives have a stronger focus on the side of businesses, collecting regularly the opinion of top managers or setting objectives for the companies and monitoring their achievement. Examples are:

- Ceres, a non-profit organisation founded in 1989, working with investors and companies, which in 2010 release a Roadmap for Sustainability, with 20 expectations in the area of governance, which realisation is monitored through regular reports;\textsuperscript{181}

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\textsuperscript{170} Ireland, P. (2012), cit., p. 3.
\textsuperscript{171} Veldman, J., Gregor, F., Morrow, P. (2016), cit., p. 16.
\textsuperscript{172} Sjåfjell, B., Johnston, A., Anker-Sørensen, L., Millon, D. (2015), cit.
\textsuperscript{173} Available at (link).
\textsuperscript{174} Available at (link).
\textsuperscript{175} Available at (link).
\textsuperscript{176} Stout, L.A. et al. (2016), cit.
\textsuperscript{177} Available at (link).
\textsuperscript{178} Available at (link).
\textsuperscript{179} The British Academy (2018), ‘Reforming Business for the 21\textsuperscript{st} Century – A framework for the Future of the Corporation’.
\textsuperscript{180} The British Academy (2019), ‘Principles for Purposeful Business – How to deliver the framework for the Future of the Corporation’.
\textsuperscript{181} Ceres (2010), The 21\textsuperscript{st} Century Corporation: The Ceres Roadmap for Sustainability.
Against these developments, it is now widely recognised that there is a need to go beyond the shareholder-centricity and ensure greater representation to stakeholders’ interests in the boardroom, also as a way to promote company’s sustainability.\textsuperscript{184} As concerns the situation on the ground, available sources underline how in Europe the role of stakeholders varies considerably across companies, sectors, and countries. In some Member States, the rights of stakeholders are enshrined in company law or other related legislation, such as codetermination and employment-protection legislation. By contrast, companies in other countries have a tradition of focusing more narrowly on the interests of shareholders.\textsuperscript{185} Nonetheless, it is argued that, to some extent, all jurisdictions recognise the duty to take stakeholders’ interests into account, although differences exist across various EU countries as regards how corporate law and corporate governance codes concretely describe the way directors should take account of the interests of stakeholders other than shareholders.\textsuperscript{186} Moreover, there is no jurisdiction that requires the board and senior managers to ignore other interests, even under the monistic approach.\textsuperscript{187} There is therefore room to further clarify how the interests of all stakeholders impacted by the activities of a company should be concretely taken into account by corporate boards in EU.

Moreover, there is agreement in the literature concerning the importance that boards protect and promote the interest of the company, and that this latter should imply to investigate, identify and mitigate the risks and impacts that might affect the contribution of the company to the societal goal of sustainability. Concerning sustainability risks, as maintained by Accountancy Europe, “the board should investigate how the SDGs and the planetary boundaries affect the business and how business is impacted by them. It is a prime board business responsibility – not an altruistic concern. The centrality of business model transformation must be reflected on the board’s agenda as a number one priority”.\textsuperscript{188} In the literature, Eccles and Youmans made a strong call to be more specific about the responsibility of the boards in determining materiality\textsuperscript{189} in order to fulfil their responsibilities towards the sustainability of the companies.\textsuperscript{190} Sjåfjell also underlined the need for corporate boards to acknowledge and deal with the financial risk of unsustainability and internalise ESG

\textsuperscript{186} Sjåfjell, B., Johnston, A., Anker-Sørensen, L., Millon, D. (2015), cit., p. 98.
\textsuperscript{187} Accountancy Europe (2019), 10 Ideas to Make Corporate Governance a Driver of a Sustainable Economy, Cogitò series.
\textsuperscript{188} Materiality is a key concept on financial reporting, auditing and accounting. The concept of materiality is used to define issues that are important for a company or a business sector. A material issue can have a major impact on the financial, economic, reputational, and legal aspects of a company, as well as on internal and external stakeholders of that company. In financial reporting, materiality is commonly thought of as a threshold for influencing the economic decisions of those using an organisation’s financial statements. According to the GRI, materiality in sustainability reporting includes considering economic, environmental, and social impacts that cross a threshold in affecting the ability to meet the needs of the present without compromising the needs of future generations. For more information on materiality in sustainability reporting, see GRI (2015), ‘Materiality: what topics should organizations include in their reports?’ Available at (link).
\textsuperscript{189} Eccles, R., Youmans, T. (2015), cit.
concerns into their decision-making.\textsuperscript{191} There are instances of non-EU jurisdictions where addressing sustainability (and climate in particular) risks is already considered part of the directors’ duty of care, meaning that failure to consider such risks might leave directors and officers open to actions against the corporation and in some cases, the directors and officers personally.

As regards **sustainability impacts**, preventing and mitigating adverse impacts on the environment and on workers, communities and consumers is one of the most pressing challenges companies face in today’s globalised marketplace. In particular, the growing societal awareness about the significance of companies’ social impacts has inspired mounting support for the adoption of legislation imposing mandatory human rights due diligence.\textsuperscript{192} Going beyond the “soft law” of the UN Guiding Principles on Business and Human Rights and the OECD Guidelines for Multinational Enterprises – whose implementation level remain limited, as demonstrated by the 2019 finding by the Corporate Human Rights Benchmark\textsuperscript{193} – a “legislative tide” has mounted with relevant legislative initiatives on human rights due diligence being adopted in UK (2015 Modern Slavery Act), France (2017 Duty of Vigilance Law), the Netherlands (2019 Child Labour Due Diligence Law), with Finland and Germany possibly joining this trend.\textsuperscript{194}

<table>
<thead>
<tr>
<th>Main issues emerging from the literature review</th>
</tr>
</thead>
<tbody>
<tr>
<td>- There is wide room for interpretations of directors’ duties and “company’s interest” and as currently defined in EU jurisdictions. The lack of strict indications in national jurisdictions together with the widespread adoption of the social norm of “shareholder primacy” over the last 40 years, brought to interpretations that favoured short-term shareholder value maximisation over the long term interest of the company as a separate legal entity;</td>
</tr>
<tr>
<td>- In the current corporate governance theory and prevailing practice, strongly influenced by the shareholder primacy, the interests of stakeholders (other than shareholders) are largely ignored by the boards in their decision-making, undermining the sustainability and long-term success of the company;</td>
</tr>
<tr>
<td>- Boards are engaged in the identification and mitigation of the economic, social and environmental factors that affect the long-term prospect of the company only to a limited extent and there are several calls to put these aspects on top of the boards’ agenda to eventually link directors’ duties to the interest of the company.</td>
</tr>
</tbody>
</table>

### 7.1.2 State of play in 12 EU Member States

#### 7.1.2.1 Regulatory framework

**Relevant EU regulatory framework**

\textsuperscript{191} Sjåfjell, B. (2018), cit., pp 41-62.

\textsuperscript{192} On 2 December 2019, over 100 organisations and networks have joined today civil society call for the Commission to develop corporate accountability legislation requiring companies to respect human rights and the environment in their global value chains and operations.

\textsuperscript{193} Considering all indicators for corporate human rights performance in aggregate, more than half of the 200 benchmarked companies score less than 20% and only 1 in 10 companies score more than 50%. These extremely low scores reveal poor levels of implementation of the UNGPs by the vast majority of companies assessed, which is particularly concerning given that the study focuses on 200 of the largest corporations in the industries with the highest risks of negative human rights impacts (agricultural products, apparel, extractives and ICT manufacturing). See the Corporate Human Rights Benchmark (2019), *Corporate Human Rights Benchmark: 2019 Key Findings*. Available at [link].

\textsuperscript{194} In its 2016 National Action Plan on Business and Human Rights, the German government undertook to consider introducing legislation on human rights due diligence if by 2020 less than half of German companies with over 500 employees have human rights due diligence processes in place. A first monitoring survey was launched in summer 2019, but a draft law leaked in February spurring the political debate. Finland announced on 3 June 2019 that it would work to adopt mandatory human rights due diligence at the national and European level, where it assumed control of the EU presidency on 1 July 2019. See Berthet, A. (2019), ‘Emerging Voices: Momentum Builds for Mandatory Human Rights Due Diligence’, OpinioJuris. Available at [link].
Regarding the **engagement of shareholders**, the Shareholder Rights Directive II\(^{195}\) covers a number of topics:

- The development and public disclosure of an engagement policy by institutional investors, describing how they monitor investee companies and exercise voting rights on matters including strategy, financial and non-financial performance and risk, social and environmental impact and corporate governance;
- The facilitation by intermediaries of shareholders’ participation and vote in general meetings;
- The disclosure requirements for proxy advisors.

### Definition of directors’ duties

**Directors’ duties and liabilities are defined by the law in all 12 Member States.** Legal provisions in this regard apply to all companies, regardless of their type (listed, non-listed), size, or sector of operation.

**The existing definitions do not include explicit requirements for board members to identify and mitigate the economic, social and environmental factors and focus more generally on the duty to act in good faith and in the best interest of the company.** Indeed, in all 12 Member States analysed, directors must fulfil their duties with care. In this regard, directors must perform their roles as loyal representatives, operating in good faith and in the best interest of the company. Directors must hold their position and comply with the duties imposed by the regulations and the Articles of Association and perform all actions required to fulfil the object of the company, unless this belongs to the competence of the general shareholders' meeting.

There are **duties relating to (i) both the functioning of the company organisation (ii) and the management of the company.** For instance, the first category includes:

- The approval of a draft annual account in accordance with the law;
- Calling the shareholders meeting for the approval of the annual account;

The second category (i.e. management of the company) includes for instance:

- The obligations to pay taxes and social security contributions;
- The prohibition for directors to act in conflict of interest with the company.

With reference to listed companies, the law usually sets additional duties (see Box 3).

#### Box 3 – Examples of additional duties for directors in listed companies

In DE, the management board of companies that are listed on the stock exchange or that are subject to co-determination rights, shall stipulate target values for the percentage of women working in positions at the first and second management levels below the management board.

In FI, in listed companies the board of Directors is also responsible for evaluating the company’s internal control and risk management systems; evaluating whether the company’s related-party transactions are done at an arms-length basis; evaluating the auditor’s independence; drafting the company’s remuneration report.

In PL listed companies are subject to the extensive reporting obligations associated with an event that have significant impact on an economic or financial standing of the company or that might significantly affect a price of its shares. Obligations in this regard are usually carried out by the Directors in form of a report publication, disclosed *ad casum* or periodically.

In PT, additional specific duties may apply to directors in listed companies such as the need to include a corporate governance chapter in the management annual report, as foreseen in article 245-A of the Portuguese Securities Market Code, implementing the EU Accounting Directive, which might, but does not have to, include information on sustainability.

In SE, directors of listed companies shall also provide written instructions on the allocation of work between the directors, the CEO and any other administrative organ.

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Definition of “company’s interest”

By means of introduction, our analysis of “company’s interest” and “company’s purpose” reported in this section makes reference to what companies’ legislation expressly states. For this analysis, “interest” and “purpose” are to be intended as follows:

- **Interest** is the principle inspiring the action of the directors in order to reach company’s purpose;
- **Purpose** as the ultimate goal that the company aims to achieve. It is not solely linked to the specific economic activity that the company carries out, and can go beyond that to include other goals that the company has set to create value.

When analysing national company legislation and the related main codes and principles, **company’s interest is defined only in half of the Member States under investigation (6)**. When a definition exists, it is included either in the provisions of law (3 Member States) or in the case law and doctrine (3 Member States),

<table>
<thead>
<tr>
<th>MS</th>
<th>Definition</th>
<th>Source</th>
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<tbody>
<tr>
<td>FI</td>
<td>The management of the company shall act with due care and promote the interests of the company. In practice, promoting the interest of the company has been interpreted as fulfilling the company’s purpose, which is to generate profits for the shareholders, unless otherwise provided in the articles of association.</td>
<td>Limited liability companies act (624/2006; henceforth, Companies act), chapter 1, section 8.</td>
</tr>
<tr>
<td>SE</td>
<td>The interest of companies is to generate profit for distribution to its shareholder(s).</td>
<td>Chapter 3, Section 3 of the Swedish Companies Act</td>
</tr>
<tr>
<td>DE</td>
<td>The company’s interest is not explicitly regulated by a provision of law. It is, however, included in the definition of the management’s obligation to manage the company (e.g. Sec. 76 para. 1 German Stock Corporation Act) or in the management’s liability (e.g. Sec. 43 para. 1 German Limited Liability Companies Act). A stock corporation’s interest consists of the bundled interests of the shareholders, which would mainly be income return oriented. It is argued that the company should also take into account all the stakeholders’ interests (“stakeholder value concept”), the majority in German legal literature however seems to support a “moderate shareholder value concept”, meaning that the company’s management may observe stakeholders’ interests more than what is usual in the respective market, if this is expected by the public and if the company’s image as “good corporate citizen” shall be maintained.</td>
<td>Fleischer in Spindler/Stilz: Commentary on the German Stock Corporation Act (4th edition, 2019), Sec. 76, margin no. 36 et seq.; Ziemins in Michalski/Heidinger/Leible/J. Schmidt: Commentary on the German Limited Liability Companies Act (3rd edition, 2017), margin no. 178</td>
</tr>
<tr>
<td>PL</td>
<td>The law doesn’t provide for a definition of ‘company's interest’. However, the relevant case law provide that: the company's interest is determined by all those aspirations and behaviour of the shareholders that aim at achieving a common goal guiding its establishment and specified in the articles of association or in the statute of a joint-stock company, in which this goal is its constitutive element. This concept is used in the case-law.</td>
<td>Supreme Court verdict dated November 5, 2009 (no. I CSK 158/09).</td>
</tr>
<tr>
<td>FR</td>
<td>The law does not provide a definition of 'company's interest' but the law indicates that a company is managed in its interest. The legislator did not wish to define this concept, which varies according to the activity and environment of each company. Case law also considered the question of the respect of the company’s interest but not give a definition. However, it is considered by part</td>
<td>Article 1833 of the French Civil Code, article L 225-35 and L 225-64 of the French Commercial Code</td>
</tr>
</tbody>
</table>

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196 BE, FI and SE.
197 FR, PL and SI.
### Table

<table>
<thead>
<tr>
<th>MS</th>
<th>Definition</th>
<th>Source</th>
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<tbody>
<tr>
<td></td>
<td>of the doctrine (Doctrine: Example: Mémento Sociétés commerciales 2019, §13220) that company's interest cannot correspond to the interests of the shareholders.</td>
<td>Companies Act (Official Gazette of RS, no. 65/09 - officially consolidated text, 33/11, 91/11, 32/12, 57/12, 44/13 – odl. US, 82/13, 55/15, 15/17 and 22/19 – ZPosS).</td>
</tr>
<tr>
<td>SI</td>
<td>The company's interest is not defined per-se in a separate article. However, it has been defined by legal scholars and experts through law commentary and court practice when, for example: - defining liability of directors/board members as any act which in any way deteriorates the position of the company. It is usually included as one of the breaches of management - e.g. acting against company interests. Also it is included for example in the rules for convening a general meeting as one of the conditions for it - &quot;if necessary for the company's interests&quot;.</td>
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</table>

When the definition exists, it is linked to:

- **The interests of shareholders in most of the cases** (4 Member States). In particular, in FI and SE 'company’s interest’ is defined as the interest to generate profit for distribution to its shareholders. In PL, company’s interest is linked to the interests of shareholders to achieving a common goal specified in the article of association. In DE, company’s interest definition is included in the definition of the management’s obligation to manage the company (e.g. Sec. 76 para. 1 German Stock Corporation Act) or in the management’s liability (e.g. Sec. 43 para. 1 German Limited Liability Companies Act), and it is defined as the bundled interests of the shareholders, which would mainly be income return oriented. However, the majority of legal literature supports a "moderate shareholder value concept", meaning that the company's management may also observe stakeholders' interests. For the LLCs (GmbH) and for Stock Corporations (AG) the prevailing opinion in German legal literature (for both types of entities) is that the “shareholder value” prevails. Hence, the interests of the shareholders determine the company’s interest. For the GmbH the literature is divided, and some believe that the “stakeholder value” shall prevail.

- **The interests of both shareholders and other stakeholders in the remaining cases** (2 Member States). In particular, in FR and SI ‘company’s interest’ does not correspond only to the interests of the shareholders but encompasses the interests of clients, creditors, third parties as well.

Except for the few cases above, the law does not define what the interest of the company. There are no indications/guidance in most of the Member States on how this term is to be understood.

As concerns the related concept of company’s purpose, it is defined in most of the Member States through provisions of law (9) and is defined in terms of generation of profits. In addition, article of associations may include different purposes such as charitable or not-profit. However, in such cases, national laws allow investors to set up profit making companies (which are not charities and not non-profit organisation) that are allowed to additionally pursue a general public benefit taking into account that the main purpose still remains the profit generation for shareholders.

Despite company’s purpose is generally defined as generation of profit, all Member States, except ES and NL, provide profit-making companies with the possibility to additionally pursue a general public benefit, considering that the main purpose remains linked to the generation of profits. Indeed, some Member States introduced specific requirements:

- In SI, HU, PT and BE it is possible that a profit-making company pursues a general public benefit, as long as the company still has profit distribution as its main purpose. The

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198 DE, FI, PL, SE.
199 Supreme Court verdict dated November 5, 2009 (no. I CSK 158/09).
200 However, the majority of the literature and the Federal Court of Germany support the "shareholder value" approach.
201 BE, DE, FI, FR, HU, IT, PT, SI, SE.
company is allowed to carry out actions related to general public benefits as long as these are, directly or indirectly, driven/convenient towards obtaining profit;

- In DE, there are no laws against the process of deciding by shareholder resolution that part of the profits shall be used to support a general public benefit; however, this is not possible if the article of association determine the use of profits in a particular way. The management is not entitled to use the company’s profits in a charitable way unless provided for in the article of association;

- In FI, SE and IT, profit-making company is allowed to additional pursue a general public benefit. However, to do so, company’s article of associations must include the possibility to pursue a general public benefit. Otherwise, pursuing a general public benefit would not be possible.

In addition, in FR and IT a commercial company can also be a benefit corporation ("société à mission" in FR and ‘società benefit’ in IT) in so far as it meets the following criteria:

- Its articles of association specify a corporate purpose of social utility;
- Its articles of association specify one or more social and environmental objectives that the company has the mission to pursue;
- Its articles of association specify the modalities for monitoring the execution of said mission;
- The company declares to be a benefit corporation to the commercial and companies register.

The fact that a company is listed or unlisted, is of a certain size or operates in a business sector or in another does not impact the described regulatory framework regarding company’s interest and company’s purpose. This is applicable to all Member States under analysis.

7.1.2.2 Market practices

Although the web-survey provides only limited evidence concerning market practices, the following points can be highlighted:

- **Duty of care**: sustainability is considered as part of the duties of the corporate board. According to all companies replying to the specific survey question, the duty of care of the board also encompasses sustainability matters. 62.5% of the business associations and 72.7% of the investors that responded to the survey expressed the same point of view. It should be remarked, however, that a few business associations and investors were unable to respond, which might be interpreted as a lack of a clear understanding of the scope of the duty of care and its interplay with sustainability. No specific differences emerged as concerns country, sector and company size.

- **Interpretation of company’s interest**: the “impact on employees” is the most cited (87.5% of the respondents) sustainability-related element that might be included in the interpretation of company’s interest, followed with 75% by the “impact on customers”, “the presence of long-term objectives”, and “the impact on local communities”, and with 37% by “the impact on global communities along the value chain”, and “the impact on other businesses in the supply chain”. No specific differences emerged as concerns country, sector and company size.

- **Identification of sustainability risks and impacts**: company boards are currently already involved in the identification of sustainability risks and impacts. All companies and 89% of the business associations responding to the survey report that boards play a role in the sustainability risks and impacts identification process. No specific differences emerged as concerns country, sector and company size.

7.2 Pressure from investors

7.2.1 Evidence from the literature

The literature review highlighted two factors that contribute to short-termism in corporate decision-making:
• Changes in share ownership structures and emergence of activist investors
• Disclosure of quarterly returns and earnings guidance.

The following sections analyse in detail each factor by firstly illustrating how they relate to short-termism, and then presenting the key supporting evidence retrieved from the documents analysed.

**Changes in share ownership structures and emergence of activist investors**

*How does this factor relate to short-termism?*

The growing focus of companies on short-term maximisation of shareholder value is also the consequence of broader changes in share ownership patterns and at financial level.

Since the 1980s, **the rise of institutional investors in the share ownership structure of companies has come together with a steady increase in the turnover rate of equities and with a “shift in focus” of investors’ engagement towards the creation of short-term value.** The increase in share ownership by institutional investors means that a growing proportion of public equity is no longer owned by the members of the communities where a company is located or its employees, but rather by large entities, transcending community or national ties, whose main interest in companies is share price gains. The behaviour of investors regarding their decisions’ horizon has been pointed out as an important driving force of short-termism trends. The rationale between investors’ horizons and short-termism is that trading based on momentum and/or price movements rather than value is pressuring companies to deliver results and to employ strategies to sustain their share prices.

The emergence and growing importance of explicitly short-term oriented institutional investors, such as **activist hedge funds**, has created an overall dynamic in which institutional investors exert pressure on corporate boards to maximise shareholder value in the short-term, rather than pursue long-term interest. Activist shareholders tend to take a short-term approach, as their typical strategy is to identify target companies that they view as “underperforming” and, after having gained a sizable share of company’s stocks at the current price, use the acquired shareholding to pressure for changes that would substantially boost the market value of the company stocks, such sale or split-up of the company, asset restructuration, change in governance structure or the board, or change in payout policy. In fact, increasing pay-outs to shareholders is one of the most frequent requests by activist investors to companies. If the campaign succeeds, they liquidate their stake and realise the resulting price increase. As summarised by Lipton, activist hedge funds “typically focus on immediate steps [...] that may create an increase in the company’s near term stock price, allowing the activist to sell out at a profit, but leave the company to cope with the increased risk and decreased flexibility that these steps may produce.”

The rise of institutional investors also resulted in a **diminished length of shares ownership** by investors. Indeed, major institutional shareholders face pressures that encourage them to focus strongly on share price maximisation in the short-term. Existing literature underline how pension funds are under heavy pressure to generate investment income to meet the legal obligations they have to their retirees. In terms of trading strategies, this results into a focus on short-term stock price performance and high turnover rates to realise short-term price increases in order to obtain cash. Mutual funds compete with each other for investor money on the basis of their year-to-year performance (annual returns on its assets), and fund managers that

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underperform are under the threat of reduced compensation or even termination. Because of the pressure to meet annual performance targets, fund managers will adopt investment strategies that are more likely to yield positive performance in the short run and achieve acceptable year-end results. This might occur at the expense of long-term investment opportunities, even if such opportunities have higher expected returns than those shorter-term opportunities.\textsuperscript{208} As highlighted in recent report by the European Securities and Markets Authority (ESMA), “asset managers are continuously assessed against market benchmarks, which challenges their ability to take a longer-term view and tolerate periods of underperformance by firms in which they may fundamentally believe".\textsuperscript{209}

**Changes in the stock market itself contributed to increase the turnover rate of equities and diminish the length of share ownership.**\textsuperscript{210} Technological and regulatory changes have reduced the costs of trading shares, giving rise to high-frequency traders, and more frequent trading by many other market participants. Stock markets have largely become trading platforms in which capital is directed not to business but to traders. In fact, trading does not provide capital for investment to the businesses, it simply flows capital between shareholders.

**Supporting evidence**

Over the recent decades, the weight of households in the share ownership of European companies progressively decreased, while institutional investors have become the dominant owners of public equity in most OECD countries.\textsuperscript{211} It is estimated that households held 28% of market capitalisation in 1975, a figure dropped at around 10-11% in 2012.\textsuperscript{212} According to a 2019 OECD report,\textsuperscript{213} as of the end of 2017, in European listed companies institutional investors own 38% of the total market capitalisation, followed by private corporations (13%), the public sector owns (9%), strategic individuals and families (8%), and other free-float including retail investors (32%). In general, asset managers have become the dominant players in the investment chain, as individual shareholding has declined and pension funds and insurers have responded to incentives (including demographic changes and regulation) to reduce their investments in equities.\textsuperscript{214}

Together with changing patterns in share-ownership, there has been also a notable decrease in the average shareholding period by investors and increase in portfolio turnover in EU over the last decades, as shown in Box 4 below.\textsuperscript{215}

**Box 4 - Portfolio turnover and holding period in selected EU Member States**\textsuperscript{216}

<table>
<thead>
<tr>
<th>Country</th>
<th>Average Holding Period</th>
<th>Portfolio Turnover</th>
</tr>
</thead>
<tbody>
<tr>
<td>Austria</td>
<td>6.7 years</td>
<td>44.5%</td>
</tr>
<tr>
<td>Belgium</td>
<td>7.2 years</td>
<td>48.3%</td>
</tr>
<tr>
<td>Croatia</td>
<td>6.9 years</td>
<td>45.7%</td>
</tr>
<tr>
<td>Finland</td>
<td>8.1 years</td>
<td>52.6%</td>
</tr>
<tr>
<td>France</td>
<td>7.3 years</td>
<td>49.8%</td>
</tr>
<tr>
<td>Germany</td>
<td>6.8 years</td>
<td>46.9%</td>
</tr>
<tr>
<td>Hungary</td>
<td>7.5 years</td>
<td>51.2%</td>
</tr>
<tr>
<td>Italy</td>
<td>7.8 years</td>
<td>53.4%</td>
</tr>
<tr>
<td>Netherlands</td>
<td>7.4 years</td>
<td>50.7%</td>
</tr>
<tr>
<td>Poland</td>
<td>7.6 years</td>
<td>51.8%</td>
</tr>
<tr>
<td>Portugal</td>
<td>7.9 years</td>
<td>53.9%</td>
</tr>
<tr>
<td>Slovakia</td>
<td>8.2 years</td>
<td>55.2%</td>
</tr>
<tr>
<td>Slovenia</td>
<td>8.0 years</td>
<td>54.3%</td>
</tr>
<tr>
<td>Spain</td>
<td>8.3 years</td>
<td>56.4%</td>
</tr>
<tr>
<td>Sweden</td>
<td>8.7 years</td>
<td>58.5%</td>
</tr>
</tbody>
</table>

The length of investors’ horizons can be assessed by the Portfolio turnover or by the holding period of stocks.\textsuperscript{217} While the first indicator is defined as the ratio of the total value of traded stocks to the market

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\textsuperscript{210} The Conference Board (2015),cit.


\textsuperscript{214} Kay, J. (2012), cit.


\textsuperscript{216} The analysis of the average holding period covers the following Member States: Austria, Belgium, Croatia, Finland, France, Germany, Hungary, Italy, Netherlands, Poland, Portugal, Slovakia, Slovenia, Spain, Sweden and the United Kingdom.

capitalisation of the company over a specific period, the Holding Period of a stock is the amount of time that this type of security is held by an investor. Both measures are equivalent, as the Portfolio Turnover over a year, is the inverse of the holding period (in years). Therefore, the average holding period in a given year was calculated by dividing the sum of the market capitalisation of listed companies in each country by the sum of the total value of stocks traded, according to the formula:

\[
\text{Average Holding Period} = \frac{1}{\text{Portfolio Turnover}} = \frac{\text{Market Capitalization}}{\text{Total Value of Stocks Traded}}
\]

Figure 6 displays a decrease of the Average Holding Period of stocks from approximately 2 years in 1988 to 1.2 years in 2018, which correspond to an increase in the Portfolio Turnover from 50% to 83%. These results are in line with the short-termism hypothesis as the average length that a share owner is willing to wait for financial returns has decreased by 40% in the past 30 years. On top of that, Figure 6 suggests that, during an economic crisis, investors tend to retain stocks for shorter periods.

As highlighted in the ESMA report on undue short-term pressure on corporations, “the regulatory framework strongly affects how institutional investors allocate their assets and consequently what their “aggregate holding period” is. The combination of mark-to-market valuation methods, risk-based capital requirements, and liquidity requirements, may encourage procyclicality and shorten the investment horizon of institutional investors. For instance, Solvency II discourages insurance companies, which are natural long-term investors and clients of asset managers, from investing in long term assets like equity”.

Increased portfolio turnover by shareholders has been linked to negative impacts on R&D spending by European companies. An empirical study examining the relationship between ownership structures in a sample of 324 large European companies and their R&D spending over 8 years finds that, where institutional investors seeking short-term profits hold

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218 A limitation of this approach is that a small number of stocks can bias the aggregate levels of portfolio turnover and the holding period of a specific country. If, for example, 10% of securities is frequently transacted, the overall portfolio turnover will be higher even though the majority of stocks is not traded.


220 Pro cyclicality can be defined as investing in the short term in a way that could exacerbate market movements and contribute to asset price volatility, or investing in the medium term in a way that might exaggerate the peaks and troughs of asset price or economic cycles. See Bank of England Procyclicality Working Group (2014), Procyclicality and structural trends in investment allocation by insurance companies and pension funds: A Discussion Paper by the Bank of England and the Procyclicality Working Group. Available at (link).


large blocks of shares, this has a negative influence on R&D spending, presumably because they are able to put pressure on executives to maximise profits and distribute larger dividends. Reduced R&D investments dampens innovation and, in the long-run, reduces competitive advantage.\footnote{Veldman, J., Gregor, F., Morrow, P. (2016), cit.}

Moreover, there is evidence of \textit{shareholder activism becoming prominent in Europe}, although still a long way behind the US.\footnote{To provide a reference, the annual number of companies publicly targeted in the US ranged from more than 300 to nearly 500 over the period 2014-2017. Based on Activist Investing (2017), \textit{Activist Investing in Europe: A special Report}. Available at \url{link}.}\footnote{Activist Investing (2019), cit.} Based on data from Activist Insight,\footnote{Activist Investing (2019), cit.} shareholder activism reached record levels in 2016, with 163 Europe-headquartered companies publicly subjected to activist demand as of Q3, a trend that persisted over the following years. By comparison, it is reported that there were just six activist campaigns targeted at European firms worth over €1 billion back in 2009.\footnote{Goldsmith, C. (2019), 'Charting the rise of Europe's shareholder activists', \textit{EuropeanCeo}, 11 February 2019. Available at \url{link}.} Considering campaign taking place between 2013 and 2019 (Q3), shareholder activism seems to be concentrated in a few European countries, namely UK (210 companies targeted over the period), Germany (78), Sweden (50), Poland (43), France (39), and Italy (34).\footnote{Activist Investing (2019), cit.}

In several European countries, the public debate to counter these trends focused on fostering long-term oriented and active shareholder engagement by \textit{promoting the concepts of ‘enlightened shareholder value’} (see section 7.1) \textit{and stewardship}.\footnote{According to the 2012 UK Stewardship Code, stewardship applies to asset owners and asset managers, and is understood as “the responsible allocation, management and oversight of capital to create long-term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and society”. At EU level, the Shareholders Rights Directive II also includes elements of stewardship. Through increased transparency requirements, the Directive encourages institutional investors and asset managers to adopt more-long-term focus in their investment strategies and to consider social and environmental issues following a ‘comply or explain’ approach, and grants shareholders’ a right to have say on directors’ pay.} For example, the UK Financial Reporting Council encouraged institutional investors to exhibit stewardship in order to promote the long-term success of companies “in such a way that the ultimate providers of capital also prosper” and to benefit “companies, investors and the economy as a whole”\footnote{Financial Reporting Council (2012), 'The UK Stewardship Code'.}, Stewardship codes or similar initiatives have been adopted in all EU Member States, showing a large acceptance of this concept.\footnote{EY (2017), 'Q&A on Stewardship Codes'. Available at \url{link}.}

However, \textit{also the concept of stewardship has come under criticism}. It is observed that, as in reality, most of a company’s shareholders are minority shareholders with limited capacity to voice their views, and many of them focus primarily on the market value of their shares, rather than on engagement with management and corporate strategy as a means to improve corporate performance (Box 5).\footnote{Veldman, J., Gregor, F., Morrow, P. (2016), cit.}

\begin{boxedtext}

\textbf{Box 5 – Overview of the main issues related to the concept of stewardship}

The concept of stewardship provides that institutional investors and asset managers are expected to actively engage with company management to provide effective oversight and long-term vision of corporate strategy and performance. At the EU level, the Shareholder Rights Directive II (whose transposition period ended in June 2019) aims at promoting effective stewardship and long-term investment decision-making in European listed companies. The Directive aims to encourage effective stewardship by improving transparency about how institutional investors and asset managers invest capital and how they engage with the investee companies. Through increased transparency requirements, the Directive encourages these investors to adopt a long-term focus in their investment strategies and to consider social and environmental issues. The Directive sets requirements on asset owners and asset managers to develop and publicly disclose (on a comply or explain basis) an overview of their stewardship policies and activities.

\end{boxedtext}
engagement policy. It also requires them to disclose annually how this policy has been implemented. The underlying assumption is that improved transparency will make effective stewardship a differentiating factor across institutional investors/asset managers, and that this will push towards higher standards. However, the stewardship concept is based on several problematic premises, as described by Veldman, Gregor and Morrow:\textsuperscript{233}

- “To make stewardship work, institutional investors need to be able to operate as a relatively tight and coordinated front, with clear and coordinated goals. However, institutional investment has become increasingly dispersed between different types of investors with very different interests, time horizons and nationalities;
- Stewardship implies a link between institutional investment and the end beneficiaries’ goals. However, end beneficiaries have a wide variety of goals and these interests can shift over time. In this respect, institutional investors revert to relative financial performance as the presumed common denominator;
- Rating agencies, insurers and proxy advisors provide a constraining institutional setting that prioritises short-term shareholder value. This is further exacerbated by the fact that for institutional investors with large number of corporations in their portfolio, it may prove difficult in practice to actively engage in governance beyond following the advice of proxy advisors;
- Inside institutional investors, investment and engagement strategies may diverge between professional investors and the staff who vote the stock. The funds of institutional investors are often distributed through longer investment chains. This further complicates the link to achieving the end beneficiaries’ imputed broader goals”.

Similarly, the ESMA report on undue short-term pressure on corporations\textsuperscript{234} underlines that the effectiveness of institutional investors in steering company strategy, and more specifically in pushing towards the achievement of long-term goals, should not be overstated due to a number of issues, such as:

- The scarce incentives for institutional investors to engage (rational apathy and free riding issues);\textsuperscript{235}
- The legal risks arising from collective engagement, such as those in the area of takeover and market abuse regulation;
- The tendency of fund managers to only slightly distance themselves from benchmarks (i.e. adopt a passive strategy);
- Passive reliance of investors on proxy advisors. In particular, the ESMA report flags that proxy advisors “might not always take into account long-term considerations when providing their voting recommendations” and provide advice based on “on high-level principles and a one-size-fits-all approach that might not be suitable when it comes to sustainability”.

Source: Authors’ elaboration based on Veldman, J., Gregor, F., Morrow, P. (2016) and ESMA (2019)

For these reasons, the expectation that institutional shareholders will provide effective oversight and control for the benefit of the long-term interests of corporations and their constituencies seems problematic. The underlying view promoting stewardship is one of empowered shareholders, analogous to traditional quasi-owners or to families in family control businesses. In modern public corporations, however, most shareholders who have the power to engage with or provide signals to corporations’ boards, will focus only on the market value of their shares.\textsuperscript{236}

\textsuperscript{234} ESMA (2019), cit., p. 69.
\textsuperscript{235} "Traditionally, researchers have considered monitoring as the key tool to reduce the information asymmetries between shareholders and managers […]. The corporate finance literature has investigated this matter, concluding, however, that investors lack proper incentives to monitor (i.e. they suffer of ‘rational apathy’), because rational shareholders exert the effort to make an informed decision only if the expected benefits of doing so outweigh the costs […]. Therefore, free-riding issues operate as key obstacles to effective monitoring.” See ESMA (2019), cit., p. 54.
\textsuperscript{236} Veldman, J., Gregor, F., Morrow, P. (2016), cit.
Disclosure of quarterly returns and earnings guidance

How does this factor relate to short-termism?

Another factor reinforcing the short-term orientation of companies relates to the market communication and financial reporting practices, which largely focus on the short-term financial performance.237

The quarterly disclosure of financial results is a practice required both in the US and by some European stock exchanges.238 This practice is intended to improve the transparency of the listed firms, as it allows investors to monitor the performance of the company on a regular basis, and shareholders to control short-term financial results. However, according to some academic observers such practice pushes directors to focus on the short-term financial performance of the companies.239 The way in which corporate activity is accounted for has an influence on the actions of the board, as the board will focus prevalently on those aspects that are accounted and visible to the public (especially shareholders and investors). The disclosure of quarterly returns therefore has the effect of leading directors to focus primarily on the short-term financial performance of the company.

The (voluntary) practice of issuing quarterly earnings guidance is also criticised in the literature as a factor that contributes to short-termism.240 Earnings guidance is the official prediction formulated by the company regarding its future profits, which is aimed at reducing share price volatility, obtaining higher valuations by financial analysts, and improve shareholders return. A research by Mckinsey highlighted how, while there is no evidence that issuing frequent earnings guidance creates the expected benefits as regards improved valuation, shareholder returns, or reduced share price volatility, it has real costs for the executives in terms of time spent in preparing the reports and short-term results.241 It is argued that the issuance of earnings guidance leads executives to focus too much on meeting or exceeding short-term market expectations at the cost of neglecting longer-term opportunities for the company’s development.242

Some accounting practices can also increase the focus towards short-term objectives. One example is mark-to-market which involves adjusting the value of an asset to reflect its value according to the current market conditions. When firms are required to consider this accounting principle, rather than historical cost accounting, which maintains an asset’s value at the original purchase cost, the short-term fluctuation of the market conditions will partially impact the financial statements, namely on the balance sheet. On this matter, using a general equilibrium model, Heaton et al. show that the interaction between mark-to-market accounting with regulatory capital requirements can create inefficiencies, even when market prices always reflect fundamental values. Also the 2018 Final Report by the High-Level Expert Group on Sustainable Finance (HLEG) mentions the mark-to-market accounting rules for assets held in long-term portfolios as an example of existing regulations which may encourage short-term behaviour. In particular, the HLEG noted that mark-to-market valuation would result in more income statement volatility resulting from market movements and in procyclicality. Even though the HLEG acknowledged that “there is considerable disagreement among interested parties […] on whether long-term assets on investors’ balance sheets should be valued based on the currently prevailing (daily) market prices”, the Expert Group recommended the Commission to investigate alternative accounting approaches to mark-to-market valuation for long-term investment portfolios of equity and equity-type instruments.

242 EY (2014), cit., p. 19. Available at [link].
Pressure on executives to meet quarterly earnings is one of the most often-cited drivers of corporate behaviour focused on short-term value extraction. Executive surveys illustrate the trade-off between meeting short-term market expectations and creating long-term value for the company. Historically, quarterly earnings guidance has been provided because it (i) assists the management in focusing on short-term results, (ii) makes forecasting by analysts easier, and (iii) enables hedge funds to profit from discrepancies between actual earnings and forecasted earnings. In particular, by providing investors with analysis and recommendations, sell-side analysts have a significant influence on investment behaviour, and have been indicated in the literature as contributing to short-termism in capital markets. In 2017, a survey of 342 sell-side analysts across the world found that sell-side research is overwhelmingly preoccupied with short-term financial metrics rather than long-term value creation, largely dismissive of ESG issues, and often inappropriately positive in tone, failing to deliver negative assessments of companies where necessary. The 2019 ESMA report on undue short-term pressure on corporations found that “a significant number of respondents considered sell-side analysts as drivers of short-termism, choosing this node in the investment chain as the one that contributes the most to short-termism.” Sell-side research when biased and overly focused on short-term company earnings might even lead to stock price targets and ratings that do not truly reflect a company’s long-term prospects, and result in a misallocation of capital and to impediments to the efficient functioning of capital markets. If sell-side research fails to consider material non-financial drivers of company performance like ESG factors, investors do not receive the information they need to accurately assess corporate performance and make sound, long-term investment decisions. As a consequence capital is misallocated.

On the regulatory side, the 2004 Transparency Directive (2004/109/EC) required that, by early 2007, all EU Member States must require public companies listed on EU stock exchanges to publish quarterly financial information. 2013 amendments to the Transparency Directive abolished that requirement and European companies are only required to report quarterly financial information

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246 Sell-side analysts conduct proprietary research on company securities to be sold to clients. They produce a research report and seek to estimate the stock’s future performance to make a buy, hold or sell recommendation based upon that.
247 See for instance Kay (2012), cit.: “Analysts compete with each other to predict the content of an announcement, and the company will often join in this process by providing earnings ‘guidance’. Managing earnings expectations becomes a principal concern of the company’s financial officer and investor relations personnel. The exercise need have little, if any, connection to the underlying competitive capabilities of the business.” Kay, J. (2012), cit., p. 64.
248 Aviva Investors (2017), Investment Research: Time for a Brave New World?. Available at (link). The research report highlights two main issues in sell-side research, short-termism and conflict of interests. Mainstream analysts typically spend only 12% of their time researching companies’ prospects beyond a one-year horizon (partly because they need to attend to other tasks, e.g. client marketing and corporate roadshows). Analysts acknowledge these pressures interfere with the quality of their work, as 42% of mainstream analysts agree sell-side research has a detrimental short-term focus. Moreover, only 16% of mainstream analysts consider a company’s environmental impact as relevant to constructing an investment case. Conflict of interests arise from the fact that many sell-side analysts are employed by investment banks, which intermediate between issuers and investors in capital markets. The reports produced by an analyst who works in the research department are often of interest to the investment bankers and investor-relations teams in the same organisation. The survey finds that at least 90% of mainstream analysts undertake additional caution when writing on topics sensitive to the bank they work for. And more than a third of mainstream analysts said, for the sake of their careers, they would avoid writing reports that may prove damaging to their employer’s commercial relationships. Criticisms of a client or potential client of the bank are discouraged – albeit not always explicitly – while research that generates trading activity tends to be incentivised. This dynamic is conducive short-termism across capital markets: trading volumes increase as investors are recommended to trade unnecessarily and the resulting turnover leads to shorter-term holdings. A summary of the main findings of the survey is available at (link).
financial data every six months, although many larger firms also give quarterly updates in line with US reporting practice. A study on the effects of the introduction of mandatory quarterly reporting in UK in 2007, published by CFA Institute, found that by 2015, a year after the requirement was dropped, only less than 10% of companies stopped issuing quarterly reports. Remarkably, the study supported keeping quarterly reporting, as it found that (i) the initiation of required quarterly reporting in 2007 had no impact on the investment decisions of UK public companies, and (ii) it brought to an increase in analyst coverage of public companies and an improvement in the accuracy of analyst forecasts of company earnings.

Main issues emerging from the literature review

- The rise of institutional investors in the share ownership structure of companies together with changes in the stock market brought to an increase in the turnover rate of equities and with a “shift in focus” of investors’ engagement towards the creation of short-term value;
- Companies’ market communication and financial reporting practices, such as the issuance of earnings guidance and the disclosure of quarterly returns, tend to reinforce directors’ focus on the short-term financial performance at the expense of long-term value creation.

7.2.1 State of play in 12 EU Member States

7.2.1.1 Regulatory framework

Relevant EU regulatory framework

The Shareholder Rights Directive II includes various provisions on the engagement of shareholders with issuers. Article 3(c) provides that intermediaries should facilitate the exercise of shareholders’ rights, namely the right to participate and vote in general meetings. Article 3(g) mandates asset owners and asset managers to develop and publicly disclose an engagement policy that explains how they monitor investee companies and exercise voting rights on matters including strategy, financial and non-financial performance and risk, social and environmental impact and corporate governance. Article 3(j) sets out disclosure requirements for proxy advisors, also with reference to their adherence to a code of conduct. Article 9(a)(b) provides that companies should draw up a clear and understandable remuneration report and grants shareholders the right to vote on the remuneration policy.

Concerning the disclosure of quarterly returns, a previously existing obligation has been removed through the Transparency Directive, where recital 3 states that “[t]he obligations to publish interim management statements or quarterly financial reports represent an important burden for many small and medium-sized issuers” and “encourage short-term performance and discourage long-term investment”.

This factor is mainly related to the empirical trends and developments (ownership structure, portfolio turnover, shareholder activism). The main aspect covered through the legal analysis of the regulatory frameworks is the disclosure of quarterly returns. In that regard, only in PT and ES has been identified an obligation to disclose quarterly returns. In particular:

- In ES, listed companies, whose stock or securities are admitted to trade on regulated secondary markets or any regulated market domiciled in the EU, must disclose a mid-term management statement on a quarterly basis which will include:
  - an explanation of the significant events that took place during the relevant period and their impact on the financial position of the issuer and its controlled undertakings;
  - a general description of the financial situation;

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253 Directive 2013/50/EU.
• the results of the issuer and its controlled undertakings for the relevant period.
• In PT, only certain listed companies which are credit institutions and financial companies are obligated to file quarterly returns.

7.2.1.2 Market practices

Although the web-survey provides only limited evidence concerning market practices, the following point can be highlighted:

• Changes in share-ownership: overall, the majority of respondents agree with the statement that the changes in corporate share-ownership (due to the growing role of institutional investors over the past decades) have exacerbated the focus on the short-term and quick earnings on the part of the companies, whether to a moderate (22.4%, n=11), high (26.5%, n=13), or very high-extent (16.3%, n=8). However, a polarisation can be observed in the answers of different stakeholder categories. While the slight majority of economic actors replying (n=15) agrees with the above statement from low to no extent, the majority of respondents from trade unions (n=9) and NGOs (n=6) support it from moderate to high extent. Based on feedback collected, no specific differences can be observed as concerns country, sector and company size. Open responses on this topic underline the need to distinguish between institutional investors and activist investors and hedge funds, as the former might invest in companies also with a long-term orientation and considering their sustainability strategies, while the latter tend to make hostile claims and put pressure on the management with the aim of making short-term profits.

7.3 Sustainability strategy and estimation of sustainability risks and impacts

7.3.1 Evidence from the literature

The literature review highlighted two factors that contribute to corporate short-termism:

• Existence of a sustainability strategy and targets;
• Estimation of sustainability risks and impacts.

The following sections analyse in detail each factor by firstly illustrating how they relate to short-termism, and then presenting the key supporting evidence retrieved from the documents analysed.

Existence of a sustainability strategy and targets

How does this factor relate to short-termism?

Long-term strategic orientation by companies represents a premise for sustainable development, as it is necessary to support business competitiveness over the long-term. When sustainability is considered merely as compliance costs or as a mean to improve company’s reputation through green initiatives and social philanthropy, it leaves the usual, unsustainable business models and operations unaffected.

Currently not all companies have taken a strategic perspective on sustainability matters, developing a forward-looking sustainability strategy with measurable sustainability targets. The lack of a clear strategy at company level complicates the change of unsustainable business models, the alignment of corporate sustainability initiatives with the

254 Q110 – To what extent do you agree with the statement that the changes in corporate share-ownership (due to the growing role of institutional investors over the past decades) have exacerbated the focus on the short-term and quick earnings on the part of the companies?
255 Q111–Could you please elaborate on the answer given in the previous question?
business priorities, and the engagement of internal and external company audiences. To move beyond the business-as-usual and take a longer-term perspective, the elaboration and implementation of a sustainability strategy (encompassing priorities, targets and measurable Key Performance Indicators (KPIs)) appears as a necessity.

Supporting evidence

According to the 2016 research by BCG and MIT Sloan,\(^{258}\) 90% of executives surveyed agreed that having a sustainability strategy is important to their business. However, only 60% claimed that their company has any kind of sustainability strategy. Many companies have projects, anecdotes, and examples made available to shareholders, regulators, and consumers through sustainability reports, but lack a real sustainability strategy. Moreover, the research finds that companies struggle to find a payoff from sustainability until they develop a true sustainability strategy and build a solid business case.

A key component of a sustainability strategy is the setting of sustainability targets. For example, the SDGs and associated targets and indicators provide a common framework for companies to address their environmental, social and economic challenges and embed sustainability into their organisations. In Europe, a substantial part of the business community seems to be already integrating SDGs into the business strategy, but the extent to which companies are seriously working towards their achievement remains questionable. The Ethical Corporation’s Responsible Business Trends Report 2019\(^{259}\) finds that 74% of companies surveyed in Europe have integrated SDGs into their business strategies, while 56% are using SDGs as a framework to report and communicate sustainability impacts. However, only 42% of companies surveyed in Europe measures their contributions to SDGs. This is consistent with the findings from studies by KPMG,\(^{260}\) WBCSD,\(^{261}\) and PwC,\(^{262}\) all of which found that while the majority of companies surveyed refer to the SDGs in their reporting, only a minority actually have targets and KPIs aligned to SDGs, to measure their contributions. Moreover, currently there are no studies with measurements of the extent to which businesses are actually contributing to the achievement of the SDGs and other sustainability objectives. In short, there is a significant risk of ‘SDG-washing’, i.e. that the SDGs could become a communication tool for corporate branding without actual measurement of companies’ impacts towards the SDGs. Despite many companies claim to prioritise the SDGs, only a few are putting concrete measures in place to account for the impact of what they are doing and keep track of progresses.

Estimation of sustainability risks and impacts

How does this factor relate to short-termism?

In the past, the perceived investors’ emphasis on short term performance and the regulatory framework pushing attention on issues on limited timeframes have influenced companies to focus on short-term behaviours. This approach, together with the complexity of sustainability risks and impacts management, has led to a lack of interest in dealing with ESG topics, that for their inherent properties need to be approached with a long-term view, making them secondary in respect to other business risks. This situation has fuelled the vicious cycle that has brought many companies to focus on short-termism and financial risks and impacts, thus failing to successfully manage ESG issues, with consequent impacts on their reputation, on customer loyalty and financial performance: “When incidents related to pollution, customer and employee safety, ethics and management oversight have [...] dramatic impacts on market prices, it

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\(^{260}\) KPMG (2018), ‘How to report on the SDGs’. Available at (link).

\(^{261}\) WBCSD (2019), cit.

\(^{262}\) PwC (2018), ‘SDG Reporting Challenge 2018’. Available at (link).
becomes clear that ESG issues are business issues and that their near-term market impacts reflect anticipated long-term effects on cash flows and associated risks”.

In the last decade, the scenario has started to change: according to the last World Economic Forum Report on Global Risks today’s most urgent business risks, e.g. failure of climate-change mitigation and adaptation, extreme weather events, natural disasters and cyber-attacks, are directly linked to sustainability issues. As stated by the WBCSD and the Committee of Sponsoring Organizations of the Treadway Commission (COSO), such evolution in the scenario means that sustainability risks "that were once considered "black swans" are now far common - and can manifest more quickly and significantly". These risks, and the related impacts, need to be systematically identified and strategically managed on both company and operational product development level in order for a company to be long-term competitive. Numerous examples have shown how sustainability issues can affect companies to an existential level, since a lack or incorrect identification of such risks (or the lack of integration with the evaluation of business risks) may undermine a companies’ ability to create value for shareholders in the long-term.

Supporting evidence

According to WBCSD, a sustainability risk is an uncertain social or environmental event or condition that, if it occurs, can cause a significant negative impact on the company and it includes the opportunities that may be available to an organisation because of changing social or environmental factors. ESG risks also include the potential negative consequences to a business that result from its own impacts on the natural environment (i.e. air, water, soil and biodiversity) or communities of people (e.g. employees, customers, local residents).

Within an organisation, the ERM (Enterprise Risk Management) is the key business function dealing with uncertainties, managing risks – whether social, environmental, legal, political, technological and/ or economic – and complying with regulations. As such, ERM is key to addressing also sustainability risks. In the literature, the importance of integrating a sustainability perspective into ERM is increasingly acknowledged and a number of suggestions for new frameworks and sustainability integration into existing ones have been made.

In the last two years, the sensibility of organisations on their impacts has been raised as a result of the EU Non-Financial Reporting Directive, which asks large companies to report details of the current and foreseeable impacts of the undertaking’s operations, but also asks to include a description of the policies in place to face up sustainability challenges. The Directive requires companies to also include in the non-financial statement information on the due diligence processes implemented by the undertaking regarding, where relevant and proportionate, its supply and subcontracting chains, in order to identify, prevent and mitigate existing and potential adverse impacts. As required by the NFRD, the European Commission published non-binding guidelines to support companies in the implementation of the Directive, that include some indications about the integration of “principal risks and on how they are managed and mitigated”, thus revealing an increasing focus on non-financial risks integration

265 WBCSD/COSO (2018), cit.
266 WBCSD (2016), ‘Sustainability and Enterprise Risk Management: The First Step Towards Integration’. Available at (link).
270 Communication from the Commission – Guidelines on non-financial reporting (methodology for reporting non-financial information), 2017/C 215/01. Available at (link).
within business management. In June 2019, additional guidelines\textsuperscript{271} were published by the European Commission, further stressing the relevance of climate-change-related information and a risk-based approach to such topic as “Companies are advised not to prematurely conclude that climate is not a material issue just because some climate-related risks are perceived to be long-term in nature”. This more recent guideline also introduces the double materiality principle, that encourage companies “when assessing the materiality of climate-related information, to consider their whole value chain, both upstream in the supply-chain and downstream”.

According to the Global Reporting Initiative (GRI), the independent international organisation that has pioneered sustainability reporting since 1997, the identification of sustainability risks and impacts along the value chain is one of the most important challenge for companies: “identifying companies’ vast supply networks is challenging, and tracking their sustainability performance even more so. However, measuring data and increasing transparency are powerful tools for managing the risks and grasping the opportunities of global supply chains, contributing to sustainable development and a positive effect on the bottom line”.\textsuperscript{272}

Sustainability is on the agenda of many companies, although with varying degrees of engagement on the part of the boards. Based on the literature review, there is some evidence that a considerable degree of variation exists also as to how companies estimate sustainability risks and the related impacts globally. Back in 2013, a survey\textsuperscript{273} by the WBCSD on the identification and management of sustainability risks in a sample of companies found that:

- Both the frequency and level of management review of sustainability risks varied considerably, from monthly to annually, and from project teams to boards of directors;
- The level of identification of sustainability risks differed, from project and business unit levels (i.e., bottom-up approach) to a corporate directive (i.e., top-down approach);
- Not all companies set metrics for sustainability measures nor do they include all sustainability categories in their risk assessment processes (i.e., environmental risks are considered more often than social risks);
- Not all companies perform a review or audit to ensure assumptions regarding sustainability risks were correct and adjusted accordingly. In addition, companies find it difficult to assign a monetised value to certain sustainability risks and therefore often omit such risks;
- There is no global consistency in how companies categorise sustainability issues. Some companies review economic, environmental and social issues separately and others do it in an aggregated form (including all of them into one overall ERM system).

The challenges in managing sustainability risks and impacts, and thus introducing a long-term approach, can be divided in two groups.\textsuperscript{274} First, sustainability risks and impacts have some inherent properties that differentiate them from the more traditional business risks, and namely:\textsuperscript{275}

- Temporal dynamics, i.e. the connection between short-term and long-term sustainability risks is often vague and the company may not consider any significant longer-term risks. The challenge is “to balance the time perspective of sustainability risk management in order to be long-term sustainable and short-term profitable”;
- Qualitative dimension, i.e. the difficulty to evaluate non-financial impacts and risks as well as compare them. As a result, rational or objective decisions may not be possible within a

\textsuperscript{271} Communication from the Commission – Guidelines on non-financial reporting: Supplement on reporting climate-related information, 2019/C 209/01. Available at (\textsuperscript{link}).

\textsuperscript{272} GRI (2017), ‘Supply Chain Transparency: A Change Tool for Successful Global Businesses’. Available at (\textsuperscript{link}).

\textsuperscript{273} WBCSD (2013), ‘Getting sustainability risks onto management’s agenda. Moving from theory to opportunity’. Available at (\textsuperscript{link}).


broaden framework. This means that “quantitative and qualitative approaches have to be combined to create an as good as possible basis for decision making”;  

- Deep uncertainty, i.e. neither the probabilities nor consequences of many sustainability-related events are assessable with any reasonable precision. Furthermore, quantification and estimation in such area may be a risk, because it may create a false sense of certainty.  

Second, there is a number of difficulties arising from management gaps and lack of knowledge regarding sustainability risks and impacts, and namely:  

- No clear and shared understanding of what sustainability means, i.e. there is not a shared understanding and categorisation of sustainability risks;  
- Strategic perspective is missing, i.e. “while there might be a sustainability perspective on strategy, a strategic perspective on sustainability risks is missing”;  
- Unclear responsibilities, i.e. sustainability risks might be too complex and diverse to expect the organisations’ front lines to manage them and to find a unique responsible function;  
- Perceived inherent conflict between sustainability and financial goals, i.e. there is still a perceived trade-off between sustainability and financial goals, instead of a symbiosis;  
- Vague connection to cost and value, i.e. due to their complexity, it is difficult to calculate quantitatively the influence of sustainability risks on costs and benefits. The current lack of generally accepted environmental management accounting standards can also be highlighted as a major obstacle for better environmental risk management in companies;  
- Underdeveloped social dimension, i.e. the social dimension is still underdeveloped in current risk management practices;  
- Low overall ERM maturity, i.e. “ERM as a discipline might be too immature and some necessary preconditions for sustainability integration might not be there. [...] The current degree of implementation in general might also be insufficient for adding a sustainability perspective as a new dimension”.

As concerns ERM, according to a 2016 WBCSD study, two dominant risk management frameworks are used globally to identify and manage sustainability risks: the COSO Enterprise Risk Management Framework and the International Organization for Standardization (ISO) 31000 Risk Management Standard. More than half (53%) of WBCSD member companies specified in their annual report that they use one of these two “off the shelf” ERM frameworks.  

However, questions are raised about the effectiveness of these frameworks in addressing sustainability risks. 70% of the COSO and WBCSD member companies consulted agreed that their current practices do not address sustainability risks and 44% agreed that the frameworks need to provide more guidance to companies on how to embed sustainability into ERM.  

Box 6 – Companies experience on sustainability risks  

The evaluation of sustainability risks carried out by a company not subject to Directive 2014/95/EU interviewed is still mainly linked to regulation and the external communication of the related KPIs is not mature; instead, there are several reference frameworks for measuring KPIs to monitor sustainability.

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278 Schulte and Hallstedt (2017) provide an extensive analysis of common practices related to the integration of sustainability (environmental and social) in risk management. Authors highlight that there are some practices currently in place to manage environmental cause and effect of business management (for example: products Life Cycle Assessment and Life Cycle Cost), while the level of maturity of practices dealing with social aspects is more limited (for example: customer requests, social legislation, effects on reputation, attract and retain talents, employee motivation). Also the literature provides very few insights on such topics. Source: Schulte, J. and Hallstedt, S.I. (2017), 'Challenges and Preconditions to Build Capabilities for Sustainable Product Design', Submitted to the 21st International Conference on Engineering Design. Available at (link).  
279 WBCSD (2016), cit.
impacts, like GRI, Sustainability Accounting Standards Board (SASB), Integrated Reporting and Organisation Environmental Footprint (OEF) Standards or the reporting recommendations of the Task Force on Climate-related Financial Disclosures (TCFD), which are used by the company to assess its performance. This, according to the representative from the company interviewed, makes it clear that more guidance and support on ESG related risks evaluation is needed from the authorities to support what is now being dealt with on a voluntary basis.

Source: Interview with one company in the pharma sector that voluntarily reports on sustainability performance

Some stated that “off the shelf” frameworks were inadequate for the effective management of environmental and social risks. The study concludes that “identifying emerging issues, and perhaps emerging sustainability issues even more so, is a challenge for companies that can cause a breakdown in ERM”. This has been the boost for the WBCSD, in partnership with COSO, to publish in 2018 a report to help risk management and sustainability practitioners apply ERM concepts and processes to sustainability risks.

Other international organisations such as the Natural Capital Coalition, provide some guidance on the integration of natural capital within companies’ decision-making processes, though without providing stakeholders with an explicit list or recommendations on the specific tools or methodologies to be used. For instance, the Natural Capital Protocol offers a decision-making framework that “enables organisations to identify, measure and value their direct and indirect impacts and dependencies on natural capital”, thus adopting an indirect risk-based approach towards companies’ interactions with nature and related externalities.

Existing standards (for both reporting impacts and evaluating of risks) are currently not widely used and mainly adopted on a voluntary basis by companies that already show commitment to and leadership in sustainability. In addition, these standards also proved to be not fully adequate to influence operational and/or financial decision-making at the company executive level.

In conclusion, the integration of sustainability risks and impacts in business risk management is still at an early stage, and the complexity and limits of actual methods for identifying and managing sustainability risks makes it even more difficult.

Main issues

- Sustainability strategies, encompassing measurable targets and KPIs, are not systematically elaborated and implemented by companies
- Identifying and effectively addressing sustainability risks and impacts is still at an early stage and presents a challenge for most companies

7.3.2 State of play in 12 EU Member States

7.3.2.1 Regulatory framework

Requirement for directors to develop a sustainability strategy

Only Italian legislation on Benefit corporations require directors to develop a sustainability strategy. In particular, Law no. 208 of December 28, 2015, referred to Italian Benefit corporations only, provide for the obligation to develop a sustainability strategy and the appointment of a person liable for pursuing of the common benefit purposes. It is noteworthy that in IT, with reference to general profit-making companies, directors do not have an obligation to develop sustainability strategies. In all the other Member States, there is no explicit legal requirement to develop a sustainability strategy, even if:

281 WBCSD/COSO (2018), cit.
there is the legal requirement to disclose non-financial information in all Member States under analysis (as specified below in section 7.8).

In particular, in all Member States listed companies have to draft a year-end report containing a statement concerning sustainable corporate governance. Amongst other things (diversity policy, structure of the board of directors, information about the company’s share trade policy), the sustainable/corporate governance statement includes a reference to a corporate governance code that the company follows (e.g. Corporate Governance Code 2020, international codes, etc.) and (if present) other actions that the company performs relating to sustainable governance. The Corporate Governance Code 2020 requires companies to have a sustainability strategy. If the company does not follow these guidelines, it must explain why and how it deviates (comply or explain principle).

there are specific national laws in all Member States self-regulatory measures suggesting the adoption of sustainability measures with particular reference to social and environmental fields. Indeed, depending on the activities of the company, some requirements to develop sustainability strategies may arise from social sustainability, environmental and safety and health areas.

**National laws in the 12 Member States do not specify targets to be used when designing the sustainability strategy or the non-financial statement.**

Overall, with the few exceptions described above (exceptions that, in any case, refer to listed companies only), there are neither provisions of laws nor self-regulatory measures that expressly define the requirement to design a sustainability strategy and specify its content.

The fact that a company is of a certain size or operates in a certain business sector does not impact the described regulatory framework. This is applicable to all Member States under analysis.

### 7.3.2.2 Market practices

The review of sectoral documentation available, together with the outputs of the online survey, the case study interviews with NGOs and business associations from the different sectors and with the companies selected, provide partial and often varied evidence concerning market practices in the adoption of sustainability strategy and targets and the estimation of sustainability risks and impacts.

Overall, limited information has been gathered on the sustainability strategy and the identification and management of sustainability risks, while more considerations can be drawn with regard to sustainability impacts, their management and measurement.

Annexes I.3 and I.4 above provide an in-depth analysis of current practices and related gaps in the estimation of sustainability risks and impacts in each of the 10 economic sectors in scope, based on a triangulation of sectoral documentary review, survey inputs, and feedback from case study interviews. It also includes a focus on sustainability strategy. The key points of the sectoral analysis are highlighted in the remainder of this section.

- **Sustainability strategy:** as concerns the development of a sustainability strategy, the **majority of companies** (85.7%, n=6) and **business associations** (with reference to their member companies) (81.8%, n=9) **surveyed declared to have a sustainability strategy** and the sectoral review highlighted diverse approaches depending on the sector. Generally, it emerges that even where high-level strategies have been defined and formalised in sectoral-level policies and programmes (see Box 7), these are not systematically translated into specific actions or monitored through dedicated KPIs.
Box 7 – Sustainability strategy in the chemical sector

Responsible Care is the voluntary programme to promote the sustainable development of the chemical industry, according to values and behaviours oriented towards safety, health and the environment, within the more general framework of CSR. The Program has extended its area of coverage to the responsible and sustainable management of products across four areas: transition to a low-carbon economy, increasing resource efficiency, minimising waste and caring for people and the planet. In June 2019, the guidelines of the Responsible Care management system were revised to support chemical companies in achieving increasingly ambitious and challenging social and environmental sustainability objectives.

Source: Cefic (2018), Responsible Care Management Framework

The sustainability strategies/priorities are perceived, for many sectors, as being potentially in contrast with the pursuit of continuous improvement of products and the speeding up and efficiency of business processes. As an example, a business association within the transport sector underlined how the push to reduce sustainability impacts (such as GHG emissions) appears to be in contrast with customers’ demands for increasingly shorter delivery times, and thus would require an important structural and expensive business change. Moreover, as emerged from the interviews with representatives from the business associations involved, also construction and power & utilities sectors would require important structural changes to address the sustainability challenges, which means having to evaluate a trade-off between costs reduction and increase of efficiency and the reduction or mitigation of non-financial impacts and risks.

- **Sustainability targets**: though limited, survey results indicate that sustainability targets are included within the sustainability strategy according to the large majority of respondents. More specifically, 100% (n=6) of companies, 100% (n=8) of business associations, and 73.8% overall (n=31) answered that sustainability strategies include sustainability targets. Moreover, half the companies having these targets, have aligned them to EU policy priorities (n=4 of 8 respondents to the question), the Paris Agreement (n=4), and the SDGs (n=4). Sustainability impacts are taken into account in defining the sustainability targets according to 85.7% (n=6) of companies. The information gathered from the documentary review and interviews is not granular enough to elaborate a judgement on this aspect. However, as highlighted in section 7.3.1, recent surveys underline how only a minority of companies actually have targets and KPIs aligned to SDGs, which suggests that companies that provided an answer to the survey might be ahead of their peers in terms of integration of sustainability goals into their business.

- **Estimation of sustainability risks and impacts**: the sectoral analysis highlighted different levels of maturity in the 10 sectors considered. For example, the food sector has already a good understanding of its impacts and, above all, of the environmental and social risks that affect or will potentially affect the sector in the future, mainly for its inherent properties and the strong link of the activities with the environment. Compared to the other sectors analysed, also the oil and gas sector is ahead in the process of identification and management of sustainability-related risks and impacts, mainly thanks to the long-standing management of sustainability topics and evaluation of the sectoral impacts over the years. These two sectors, indeed, show a good level of correlation between the environmental and social-related risks with the economic risks, as confirmed by the sectoral documentary review. Still, most of the analysed sectors are still far behind in identifying and assessing sustainability risks and impacts, as they focus more on business risks, i.e. those closer related to financial performance. Claiming that some sectors are ahead of others, however, does not mean that they are broadly considering the long term, and that they do not need

285 Q41 – If yes, does the sustainability strategy include sustainability targets?
286 Q42 – If yes, are sustainability targets aligned with EU policy priorities, the goals of the 2015 Paris Agreement on Climate Change, or the UN SDGs?
287 Q44 – Are company’s sustainability impacts taken into account in defining company’s sustainability targets?
288 Sector-specific information on sustainability risks (environmental, social and economic) is detailed in Annex I.3.
to take further steps to combat short termism. However, the information gathered for the sectoral analysis is not sufficient to elaborate an extended judgement on the sectors analysed.

The sectoral documentation reviewed, together with the results from the case study interviews with NGOs (n=6) and business associations (n=4), show the existence of some gaps in the identification of common KPIs to assess sustainability risks and in the integration of sustainability risks in ERM model in the large majority of sectors (except, for example in the garment sector). This is in contrast with the responses from the web-survey, according to which the process for the identification of the sustainability risks by companies occurs mainly through their integration in the ERM (n=6 of 8 respondents to the question), followed by a qualitative ad hoc evaluation (n=4), while less common is the use of a quantitative ad hoc evaluation (n=2). Among those which indicated the integration of sustainability topics into the ERM, the most critical issue in this process is the difficulty in the quantitative assessment of the sustainability risks (n=5), to which it adds the different time horizon between sustainability-related risks and other business risks (as emerged for the chemical sector).

As regards concrete measures that companies are taking to address sustainability risks and impacts, based on survey replies, the most significant measure to identify and mitigate sustainability risks and impacts is risk management (n=6), followed by audits (n=5), contract management (n=3), and due diligence (n=3). A possible cause for the discrepancies between the survey results and the sectorial analysis could be found in the limited number of companies that have taken the survey, and the fact that many respondent companies are likely to be more sensitive and mature than the average as concerns sustainability aspects.

The sustainability risk identified by the largest share of companies which answered the survey is employees’ health and safety (n=6 of 8 respondents to the question), followed by climate change that directly or indirectly affects all companies, regardless of their sector (n=4) and retention/attraction of talents (n=4). This list of most relevant risks is also confirmed by the sectoral documentation review and by the interviews with sectoral NGOs and business associations. In line with these outputs, the main adverse sustainability impacts addressed by the surveyed companies are climate change and health and safety (n=6 and n=5 respectively). These are followed by bribery and corruption (n=5), discrimination (n=4), human rights (n=4), and labour rights (n=4).

Evidence collected suggests that companies are currently focusing mainly on the identification of sustainability risks and impacts associated with their operations, without having a complete overview of the risks and impacts along the entire value chain (upstream and downstream). Some sectors are, though, more mature on this aspect. As highlighted by the documentary review and the representative from the business organisation interviewed, the food sector recognises the importance of the entire value chain while addressing risks, and all interactions and stakeholders along the food chain, including consumers, are considered. Typically, also the car manufacture and the garment sectors have a view on the entire value chain, although recognising the difficulties in the integration of the risks and impacts deriving from both upstream and downstream activities.

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289 From sectorial desk analysis it emerged that Kering currently integrates sustainability risks within its ERM model, representing a best practice in its industry. Furthermore, the Company developed a KPI called EP&L (Environmental Profit & Losses) to "accurately measure and provide a good understanding of the cost" of the Company’s activity. More information available at [link].

290 Q35 – What is the process for the identification and evaluation of ESG-related risks currently adopted by companies?

291 Q36 – If you replied "Integration of ESG-related risks in the Enterprise Risk Management", what were the most critical issues that the company encountered in the process of integrating ESG-related risks into the Enterprise Risk Management?

292 Q37 – What are the most significant measures taken by companies to identify and mitigate sustainability risks and impacts?

293 Q38 – What are the environmental, social and governance (ESG) related risks identified by companies?

294 Sector-specific information on sustainability risks (environmental, social and economic) is detailed in Annex I.3.

295 Q32 – What are the main adverse sustainability impacts (i.e. social, environmental and economic impacts associated with the lifecycle of a company’s products and operations) that are addressed by companies?
Box 8 – SME experience on the value chain

A SME interviewed confirmed the importance of considering the entire value chain both for business activities and for the identification and management of sustainability impacts and risks. Indeed, choosing high quality and sustainable resources represents an opportunity for differentiating themselves with respect to other players on the market. In light to this, the representative from the SME highlighted that the company has voluntarily chosen to localise its productive plant in a specific location, where a cluster of supplier is localised within a radius of 50 kilometres. In this way, their very short and controlled supply chain makes it easier for them to manage sustainability risks and impacts, compared to companies with a wider distribution of suppliers.

However, due to the small size of the company and the lack of specific expertise, the SME has not identified any internal risk functions, thus excluding structured risk management related to sustainability high-level risks: for example, risks related to climate change (such as natural disasters or lack of natural resources at global level) are identified by the company, but are hardly managed and mitigated.

Source: Interview with one SME within the garment sector

Good practices in managing risks and impacts along the supply chain have been identified also in the telecommunication sector (see Annexes I.3 and I.4). The integration of the risks and impacts deriving from upstream and downstream activities is though quite difficult, since it requires a close monitoring of the stakeholders involved, which translates in making audit and due diligence and, as emerged from garment sector analysis, tier 2 suppliers cannot be directly controlled, and extended producer responsibility may impact on businesses if not well addressed. As emerged from the sectoral documentary review, OECD296 provide companies with some recommendations on how to implement due diligence with regard to adverse impact, which can help enterprises “avoid and address adverse impacts related to workers, human rights, the environment, bribery, consumers and corporate governance that may be associated with their operations, supply chains and other business relationships”, while there is no specific guidelines for the evaluation and integration of sustainability risks related to the value chain into the companies’ risks mapping processes; as a result, each company manages the issue independently and differently according to its specific need and competencies, leading to a misalignment in the approaches from company to company297.

Box 9 – Supply chain management in the telecommunication sector

The Joint Audit Cooperation is a collective of telecommunication companies aiming to promote safe and fair working conditions as well as responsible, social and environmental management by verifying, assessing and promoting sustainability standards and transfer of best practice across its supply chain. Suppliers are encouraged to take all reasonable endeavours to promote and secure compliance to these Guidelines to their suppliers, sub-contractors and employees.

Source: Joint Audit Cooperation (2014), Supply Chain Sustainability Guidelines

Finally, the engagement and involvement of corporate functions in the identification and management of sustainability-related risks and the collaboration between sustainability and risk functions has not emerged as a common practice among companies. Beside some good practices in which the board and top management are involved in the definition of sustainability priorities, in the identifications of risks and in the implementation of sustainability strategy,298 (as for example, according to a sectoral business association, Oil&Gas biggest companies), there are companies and even sectors


297 No specific sector-based guidelines on sustainability risks and impacts identification and management have been indicated by any of the representatives from business associations (n=4) and NGOs (n=6) involved in the interviews.

298 An example of good practice in this sense, based on document publicly available (Transition Pathway Initiative analysis – Management Quality and Carbon Performance of Transport Companies – December 2019) is the car manufacturer sector, as of the total auto manufacturers analysed, about 70% has nominated a board member/committee with explicit responsibility for oversight of the climate change policy and the 60% incorporates climate change into executive remuneration.
for which, at present, there is no evidence of such integration and involvement. This can be one of the reasons why the most relevant sustainability topics for the sectors analysed seem not to be a pivotal point in the identification of risks, resulting in a poor correlation between the sustainability topics on the one hand and business risks addressed in the context of ERM on the other.

Box 10 - A best practice in the chemical sector

An international pharmaceutical company interviewed reported a good practice in the identification and management of sustainability-related risks, which are integrated in the Company's ERM. According to the representatives interviewed, the structured sustainability governance is the very first footstep to enhance this complete integration: the Chairman of the Board also acts as Chief Sustainability Officer, thus directly driving the sustainability strategy of the Company. This further strengthens the integration of sustainability-related topics within the business, along with non-financial targets and KPIs. Moreover, the company have introduced ESG-related long-term targets into top management's compensation schemes. To them, a structured process for the identification and management of non-financial risks and their integration within the ERM through a holistic approach represent strategic instruments to differentiate from competitors.

7.4 Board remuneration

7.4.1 Evidence from the literature

The literature review highlighted two factors that contribute to corporate short-termism:

- Director's remuneration linked to financial performance;
- Director's remuneration linked to sustainability metrics.

The following sections analyse in detail each factor by firstly illustrating how they relate to short-termism, and then presenting the key supporting evidence retrieved from the documents analysed.

Directors' remuneration linked to financial performance

How does this factor relate to short-termism?

The literature review presented two opposite positions concerning financial performance-related pay for directors.

On the one hand, there is the view that a significant part of corporate executive pay should be in the form of share options or be based on share price. The rationale is that this strategy would align shareholder and management interests, which in turn, would improve shareholder value. On the other hand, it is broadly argued that, as there is no conclusive evidence of a positive correlation between the use of share-based pay and long-term value creation, the use of share options does not create utility for corporations, for long-term oriented shareholders or for broader society. It is maintained that the use of share options and incentive plans linked to share price creates an excessive pressure on executives to pursue a short-term objective, namely increasing the short-term value of shares and share options, and that in turn, this creates pressures to employ strategic means to increase share price in the short-term, such as the strategic use of dividend increases, share buyback programmes, M&As, and layoffs. According to this strand of literature, the adoption of share-based remuneration schemes sets the conditions for a transfer of corporate funds to executive compensation and shareholders, with an increasing focus of the strategy of corporate boards on short-term value

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299 The right to buy a certain number of shares of a company at a fixed price, normally within a specific timeframe.
300 Kay, J. (2012), cit.
extraction and share price management, at the cost of investment in productive capacity and innovation for long-term value creation, e.g. through investment in R&D and employee training. Recent work by Hopkins and Lazonick points out that share-based pay leads executives to allocate corporate resources in ways that enable senior corporate executives, hedge-fund managers and other large investors to extract far more value from corporations than they help to create.

**Supporting evidence**

Data show that incentive plans linked to share price dominate executive compensation in the US and are largely diffused Europe. In the US, data collected by Hopkins and Lazonick for the CEOs of the largest US listed companies in 2015 reveal average total compensation of €17 million, with 76% from stock-based pay. In Europe, according to an empirical study on executive compensation in a sample of European listed companies, on average half of the total compensation of the European CEOs is stock-based. Data for European companies in 2015 show average total compensation of €5.1 million, with 50% from stock-based compensation. However, large differences exist between countries, with the largest proportion of stock-based compensation found in companies from the UK, France and Ireland (60%, 58% and 57%, respectively) and the lowest in Spanish and Italian companies (15% and 14%). Based on these data, even though in some EU countries the majority of total compensation is stock-based, the proportions are still largely below those that prevail in the US.

**Director’s remuneration linked to sustainability metrics**

How does this factor relate to short-termism?

Research suggests that a positive link exists between incentive-based executive compensation that includes non-financial, ESG metrics and the environmental and social performance of a company. Separate empirical studies looking at US, Canadian, and German companies found that establishing executive incentives for sustainability was effective in improving those firms’ efforts on environmental and social issues. Tying executive compensation to sustainability makes directors explicitly accountable for the environmental and social behaviour of a company and the long-term consequences of its operations, and creates pressure on them to define measurable performance-based goals. By helping align executives’ self-interests with sustainability efforts and objectives, the integration of sustainability targets in remuneration policies is regarded as an effective method to counter short-termism and improve sustainable development.

Despite the positive contribution that the integration of sustainability metrics into executive compensation might on company sustainability, linking sustainability performance to...
remuneration metrics is still an emerging trend and is still an anomaly in the market, as shown below.

Supporting evidence

Based on research published on the Harvard Business Review, in 2017 only 2% of companies within the S&P 500 linked environmental metrics to executive compensation and the most common sustainability metric used was related to safety (5%). The largest sector using sustainability metrics was the energy industry, which encompassed 25% of companies that had them. Moreover, even among WBCSD member companies, which are committed to sustainable development, only less than 40% have established links between sustainability performance and executive remuneration. According to Ceres’ progress assessment data, out of more than 600 largest US listed companies, in 2017 just 8% of companies linked executive compensation to sustainability issues beyond compliance (e.g. GHG, water management, etc.) – a 5% increase from 2014.

In Europe, FTI Consulting and CGLytics analysed the pay policies of Irish and UK companies listed on FTSE 350 and ISEQ 20 based on 2018 reporting and found that: (i) only 27.4% of companies have added ESG metrics in their incentives schemes, a percentage that falls to 12.8% of companies if ‘customer satisfaction’ is not counted as an ESG measure; (ii) while almost three-quarters of companies do not yet include ESG-related measures, there has been a marked trend towards the inclusion of sustainability into executive remuneration metrics over the past decade (as only 3% of companies included ESG measures in 2008); (iii) the proportion of pay linked to ESG performance remains small, as at the 27.4% of companies that have them, ESG-related measures account on average for less than 15% of bonuses. In a recent survey carried out by ESMA, 67% of respondents said that ESG-related objectives are not included in the variable part of directors’ remuneration. Therefore, even though there is trend towards the inclusion of sustainability into executive remuneration metrics, overall this practice seems rather limited in the market, with the exception of certain industries (such as energy) that have much to lose from accidents.

Main issues emerging from the literature review

- The adoption of share-based remuneration schemes is largely diffused in US and Europe, and creates incentives for executives to increase the short-term value of shares (for instance through share buyback programmes and M&As) and extract value for the companies;
- On the opposite, the practice of linking executive remuneration to sustainability performance is still quite limited, despite the positive effects it would have on re-directing companies towards greater sustainability.

7.4.2 State of play in 12 EU Member States

7.4.2.1 Regulatory framework

Relevant EU regulatory framework

The Shareholder Rights Directive II requires companies to grant shareholders the right to have a vote on the remuneration policy for executive and non-executive directors, and to publish a remuneration report, on which a shareholder vote is foreseen as well. Based on national transposition choice, the vote

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314 WBCSD (2019), cit.
317 Ceres (2018), cit.
318 FTI Consulting and CGLytics (2019), ESG and Executive Remuneration – Disconnect or Growing Convergence?. Available at (link).
319 ESMA (2019), cit.
at the general meeting on the remuneration policy can be either binding or advisory. The vote on the remuneration policy is in principle binding, and thus companies can only pay remuneration based on the policy approved by shareholders. However, Member States have the possibility to opt for an advisory vote. In the latter case, companies shall pay remuneration to their directors only in accordance with a remuneration policy that has been submitted to such a vote at the general meeting. Where the general meeting rejects the proposed remuneration policy, the company shall submit a revised policy to a vote at the following general meeting. The Directive also emphasises that the remuneration policy should contribute to a company’s business strategy, long-term interests and sustainability and should not be linked entirely or mainly to short-term objectives. Furthermore, directors’ performance should be assessed using both financial and non-financial performance criteria, including, where appropriate, ESG factors.

**Director’s remuneration linked to financial performance**

In all 12 Member States, with no difference between size and sectors, the board remuneration may be linked to financial performance. Listed companies generally have stricter legal requirements to adopt and disclose the remuneration policy of the directors. More specifically:

- In BE, a link with financial performance, value of share or sustainability results is not required by law. However, the year-end report must contain the remuneration policy, including a description of the link between the remuneration and performance. Performance parameters are not specified, so to be determined by the company policy.
- In HU, there is no provision on the requirement that the remuneration has to be linked to the financial performance of the company. However, under Hungarian law, a director may perform his or her duties under a service agreement or an employment agreement. The employment relationship explicitly excludes the remuneration linked to the employer’s financial performance, however, since it is possible to engage managing director under a service contract, it is worth flagging that it is possible to link the remuneration to the employer’s financial performance under a service agreement. It all depends on the basis of the relationship between the director and the company.
- In IT, the remuneration may be linked to KPIs and specific financial goals. However, with regard to listed companies, the possibility to link board remuneration to financial performances is limited by Art. 123 ter of T.U.F., that sets two conditions: 1. Adopting regulations approved by the shareholders' meeting, aimed at ensuring transparency on the policy of remuneration followed by the company; 2. Providing for quantitative limits for the variable components of the remuneration of Directors and subordinating the concession of bonus or additional benefits to the achievement of predetermined results in compliance with the sustainability of the company in the long term.
- In PL, there is a legal requirement to link the director’s remuneration with the company’s financial performance only in case of state-owned companies or financial institutions.
- In PT, in private limited liability companies by quotas (“Sociedades por Quotas”), the directors’ remuneration may be partially or totally linked to company’s profits, as long as this is duly foreseen in the bylaws. In private limited liability companies by shares (“Sociedades Anónimas”), the directors’ remuneration may be partially linked to company’s profits, as long as the maximum percentage of profits that may be allocated to the director’s remuneration is duly foreseen in the company’s bylaws.

**Director’s remuneration linked to sustainability metrics**

In all 12 Member States, with no differences between listed and non-listed companies, size and sectors, there are no law or regulatory measures that expressly link board remuneration to sustainability aspects, except for DE.

In fact, in DE since 1st January 2020 the German § 87 I 2 AktG (Principles Governing Remuneration of Members of the Management Board) states that the remuneration system of listed companies shall be aimed at the company’s sustainable development. This means that when determining the remuneration system, non-financial aspects like social and ecological ones, need to be considered.

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**Study on directors’ duties and sustainable corporate governance**

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Overall, for most of the countries there are no legal provisions regarding claw-back clauses linked to the achievement of sustainability objectives, but, at least in DE, in FR, IT and NL, claw-back clauses linked to the achievement of social and sustainability objectives could be implemented in practice through internal policies.

7.4.2.2 Market practices

Although the web-survey provides only limited evidence concerning market practices, the following points can be highlighted:

- **Linkage between directors’ remuneration and financial performance of the company**: the web-survey provides conflicting results. On the one hand, the slight majority of companies replying to the survey reported that directors’ remuneration is not linked to the financial performance of the company (57.1%, n=4). On the other hand, all business associations (that replied with reference to the companies they represent) (n=8) reported that directors’ remuneration is tied to financial performance either to high or very high extent. Based on feedback collected, no specific differences can be observed in terms of country, sector and company size.

- **Adoption of share-based remuneration**: considering their responses together, the majority of companies, business associations and investors (that replied with reference to the companies they represent and invest in, respectively) reported that share-based remuneration amounts to 30% or more of executive directors’ annual pay (57.9%, n=11), while the remuneration of non-executive directors is mostly not based on shares (59.1%, n=13). Respondents from FR and DE (n=9) indicates relatively larger shares of executive directors’ annual pay being stock-based (40% and more). Based on feedback collected, no specific differences can be observed in terms of sector and company size.

- **Trend in share-based remuneration**, according to all the companies that provided an answer, share-based remuneration as percentage of executive directors’ total annual pay remained stable over the last decade (100%, n=5), while the majority of business associations (60%, n=3) and investors (75%, n=6) believe there has been a relative increase over the same period.

- **Linkage between directors’ remuneration and non-financial performance**, evidence from the survey is mixed. The majority of companies taking the survey reported that directors’ remuneration is not tied to the sustainability performance of the company, both for non-executive (100%, n=5) and executive directors (66.7%, n=4). On this matter, the majority of investors (70%, n=7) suggested that directors’ remuneration is frequently linked to non-financial performance. Responses from business associations do not provide a clear majority.

- **Presence of members with a sustainability expertise in the remuneration committee**, evidence from the survey signals a slight majority of companies reporting to include these members in their remuneration committee (57.1%, n=4).

- **Adoption of claw-back clauses**, all the companies providing an answer to the specific question reported that directors’ remuneration is not subject to a claw-back clause linked to sustainability objectives (100%, n=6).
7.5 Board composition

7.5.1 Evidence from the literature

The literature review highlighted two factors that contribute to corporate short-termism:

- Expertise of the board members;
- Independence of the board.

The following sections analyse in detail each factor by firstly illustrating how they relate to short-termism, and then presenting the key supporting evidence retrieved from the documents analysed.

Expertise of the board members

How does this factor relate to short-termism?

The 2012 report “A New Agenda for the Boards of Directors” by the Global Compact LEAD affirms that “[i]t is now firmly acknowledged by researchers, investors and executives that corporate sustainability is key to long-term profitability and viability of most, if not all, companies.” The need for boards of directors to include sustainability at the top of their agenda is a recurrent topic in many sources consulted throughout our literature review. Sustainability-related knowledge at board level is therefore necessary to understand environmental and social issues that affect the business. The absence of relevant knowledge and expertise inside the board might significantly undermine a board’s capacity to identify and discuss sustainability risks and impacts, and to define an appropriate strategy to guarantee long-term sustainability for the company.

As shown in a recent study by the WBCSD, despite the rising importance of sustainability as a board-level governance topic, the appointment of directors with sustainability-specific competences is still limited. This kind of competences are sometimes brought to the board through other solutions, such as the creation of board-level committees responsible for ESG or sustainability oversight, or of external/independent advisory boards of experts. However, the adoption of these practices is reportedly still limited.

Still regarding board composition, the literature underlines the positive influence of diversity over the board attitude towards the long-term. The G20/OECD Principles recognise the importance of bringing a diversity of thought to board discussions and suggests that “countries may wish to consider measures such as voluntary targets, disclosure requirements, boardroom quotas and private initiatives that enhance gender diversity on boards and in senior management” (Principle VI.E.4). Diversity includes several aspects, for instance gender, age, but also diversity in the directors’ backgrounds and experiences, as discussed above. Diversity in directors’ ages could enrich board discussion since people from different age groups have diverse perspectives and life experiences. For instance, directors from older generations might bring more experience in the boardroom while younger directors could be more innovative and less risk-averse. By considering a sample of 146 companies listed in FTSE 100, DAX 30, and CAC 40 in 2009, Ferrero-Ferrero et al. found that generational diversity enables a more effective design of vision and strategies to address financial and extra-financial aspects, and consequently, it encourages companies to adopt a sustainable approach to their operations.

329 Global Compact LEAD (2012), A New Agenda for the Board of Directors: Adoption and Oversight of Corporate Sustainability. Available at [link].
331 Ceres (2017), Lead from the Top: Building Sustainability Competence on Corporate Boards. Available at [link].
332 WBCSD (2019), cit.
333 WBCSD (2019), cit.
businesses. This study concludes that generational diversity is a key component for improving corporate governance codes. However, based on the literature, the relation between age diversity at board level and sustainability performance of companies is still little researched and there is no extensive empirical evidence of its positive nature. In addition, it is maintained that a balanced board from the point of view of gender and representation of different stakes is important to challenge the business-as-usual positions and rise questions in terms of sustainability. Directors who bring a range of attributes and expertise help the board avoid group think and promote robust and scrupulous deliberations and decision-making, including on sustainability issues. Furthermore, there are indications that female directors take broader and longer-term perspectives, and diversity in general improves the reputation of the company by conforming to public expectations and better employee relations. However, as highlighted in a 2019 report by the European Commission, "the under-representation of women on corporate boards and in management positions remains an important challenge for EU Member States. This under-representation means that the potential of highly skilled and needed human resources remains untapped."

**Supporting evidence**

Research reveals that sustainability or ESG-related skills and experience are rarely taken into consideration when directors are recruited, and also within the existing board often no one is in charge of this issue. For instance, according to an international study published in 2019 by WBCSD only a quarter of the boards had at least one director with relevant experience in ESG, ethics or social responsibility. Furthermore, according to the same study, the cases where such directors nominated were geographically narrow, concentrated in a few European countries such as France, the UK and the Netherlands. Analysing the composition of the boards in more than 600 US companies, Ceres found that, out of the 774 directors who sit on relevant board committees in companies that had explicit sustainability oversight in place, only 19% had discernible or specific sustainability expertise in environmental, social, or governance issues, as described in their biographies on corporate web sites or in the nominating discussions in proxy statements.

From the point of view of diversity, many jurisdictions in Europe request companies to guarantee gender representation in the board. However, recent European Commission data show that boardrooms of the largest listed companies in EU continue to be dominated by men, and that progress in women’s presence in company boards stalled since 2015. The proportion of women on the boards of the largest publicly listed companies registered in the EU Member States reached 27% in October 2018. With 44% of its board members being women, France is the only EU Member State with at least 40% of each gender at board level. In Italy, Sweden, Finland, and Germany, women account for at least one third of board members. Despite positive improvements in cases where governments have introduced quotas for the under-represented gender (women) or taken other targeted measures, boardrooms continue to be largely filled by male members. The current state of affairs has arguably a negative effect on

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336 WBCSD (2019), cit.
337 Ceres (2017), cit.
338 Sjåfjell, B. (2014), ‘Gender Diversity in the Boardroom and its Impacts: is the Example of Norway a Way Forward?’.
341 WBCSD (2019), cit.
342 Ramani, V. (2015), View from the Top: How Corporate Boards can engage on Sustainability, Ceres. Available at [link].
343 Based on the 2019 OECD Corporate Governance Factbook (p. 167), the following EU jurisdictions have established mandatory quotas for listed companies: Belgium (33%), France (40%), Germany (30%), Italy (33%), Portugal (20% since 2018, 30.3% after 2020), Spain (40%).
boards capacity to properly address sustainability risks and impacts and keep a long-term approach in decision making. Several studies underline the positive impact of board diversity over long-term economic results, while it is more complex to measure the impact of gender diversity on the interrelated environmental and social performance of the company.

**Independence of the board**

*How does this factor relate to short termism?*

The literature review sheds lights on the existence of a debate on whether a more independent board (i.e. a board including a larger number of non-executive members) is a solution to increase the focus of the board over the long-term. The inclusion in the board of a significant share of non-executive independent directors is a commonly recognised practice that promotes effective corporate governance. Intuitively, non-executive independent directors bring to the board a third-party perspective, which can help executives to have a more balanced consideration of the interests of different company’s stakeholders and to deal with issues that affect public interest (e.g. sustainability impacts associated with business activities). From a regulatory perspective, most EU jurisdictions already include provisions on board independence for listed companies. Various authors suggest that boards with higher proportions of independent directors are more prone to voluntary disclosure and facilitate engagement in sustainability. Some of the suggested advantages of independent (or non-executive) directors include: the provision of external expertise and networks to the company board; bringing a more objective view from outside the boardroom; focusing on the corporation as a whole and its long-term interests; independence from the corporation itself (as these directors are less involved in the company’s operations) and thus the provision of effective counterweight to executives; and the idea that independent directors can stand in for or represent the interests of specific constituencies and stakeholders. According to those in favour of greater directors’ independence, independent directors are a tool to ensure accountability of the executives to shareholders by improving the quality of internal controls and of the monitoring capacities of the board as a whole.

However, the positive relation between greater independence and sustainability is contested by another part of academics in the literature. Concerns are expressed about the skill base,

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346 Board independence is measured as the proportion of independent non-executive directors on corporate boards, calculated from the number of independent members divided by the number of members on the board. The higher the ratio of independent directors to total directors, the higher the board independence.

347 See Association of Chartered Certified Accountants. Can be found at: https://www.accaglobal.com/content/dam/accaglobal/PDFstudents/2012s/sa_oct12-f1fab_governance.pdf

348 Based on the 2019 OECD Corporate Governance Factbook (p. 142), a minimum number or ratio of independent directors is required in by law in 6 Member States (BE, EL, ES, HU, IT, LT) or recommended by codes and principles in 13 Member States (AT, DK, EE, FI, FR, IE, LV, NL, PL, PT, SI, SE, UK). No requirements are present in 4 Member States (CZ, DE, LU, SK).


knowledge set and limited range of backgrounds of non-executive directors. Moreover, the assumption that independent directors are in a strategic position to provide sufficient counterweight to executives is undermined by time constraints, low remuneration, and, specifically in the US, a strong position for executives to select board members. Finally, it is argued that, due to the strong influence of the idea of shareholder primacy, also independent directors tend to understand the company’s interest as the short-term shareholders’ interest. Thus, increased presence of independent directors in board might not lead to an increased attention to indicators of sustainability performances and the long-term.

**Supporting evidence**

A meta-analysis of 87 published papers finds that the **independence of a company’s board positively influences corporate social performance** because independent directors are more likely to commit to stakeholder engagement, environmental preservation, and community well-being. Moreover, an exploratory study of the effects of board independence on the sustainability reporting practices of 500 large US firms finds that firms with a greater proportion of independent board members are more likely to engage in voluntary disclosure and, most importantly, to publish higher quality sustainability reports.

However, a recent empirical study on whether the composition of the Board of Directors affects firms’ sustainability performance covering 362 firms in 46 countries found that **a higher number of independent directors is related to lower sustainability performance**.

### Main issues emerging from the literature review

- The limited number of directors with sustainability-specific competencies and the under-representation of women in the boards might adversely affect a board’s capacity to deal with sustainability and think in the long-term;
- The inclusion of a larger number of independent directors in the boards might counter the shareholder-orientation of executives and promote a greater attention towards sustainability. However, evidence on this point is mixed.

### 7.5.2 State of play in 12 EU Member States

#### 7.5.2.1 Regulatory framework

**Relevant EU regulatory framework**

The Non-Financial Reporting Directive requires companies (on a comply or explain basis) to include in their management report a description of the diversity policy applied in relation to the management and supervisory bodies with regard to aspects such as age, gender, or educational and professional backgrounds, the objectives of that diversity policy, how it has been implemented and the results in the reporting period.

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362 Directive 2014/95/EU.
On the topic of gender balance on corporate boards, the European Commission submitted a proposal for a directive on gender balance among non-executive directors of companies listed on stock exchanges in November 2012. The proposal set the aim of a minimum of 40% of non-executive members of the under-represented sex on company boards. Companies would have to make appointments on the basis of pre-established, clear and neutral criteria. If candidates were equally qualified, advantage would be given to the under-represented sex. Member States would require companies to issue annual reports on the composition of their boards and impose sanctions in the event of negative evaluations. The directive would not apply to SMEs. For Member States choosing to apply the target to both executive and non-executive directors, a lower target (33%) would apply. The current Commission President, Ursula von der Leyen, stated in her Political Guidelines for the next European Commission (2019-2024), that she will seek to build a majority to unblock the Directive.

Sustainability experts in the board of directors

In no Member States considered in this legal review there are legal provisions that require the board to be composed of directors with sustainability expertise. However, it is not forbidden that the articles of association of the company and/or the board regulations include provisions regarding the requirement of specific expertise of directors.

Gender balance on the board of directors

On the contrary, some EU Member States (BE, DE, FR, HU, IT, PT, , SE and SI) provide for measures aimed at improving the gender balance on corporate board of companies listed on stock exchanges. For example:

- In BE, article 7:86 of the Companies and Associations Code provides that the percentage of another gender to be present in the Board of Directors of listed companies is equal to 1/3 of the Board members;

- In DE, from 1 January 2016 on, companies which are both listed on the German stock exchange as well as subject to the Law on Co-Determination (Mitbestimmungsgesetz) must accomplish the minimum requirement of 30% female members in the Supervisory Board. Said companies shall also determine a women’s quota for the Management Board and the middle management, which however can be self-set and thus does not need to be 30%.

Companies, which are either listed on the German stock exchange or subject to the Law on Co-Determination (Mitbestimmungsgesetz) shall determine a self-set women’s quota in the Supervisory Board, the Management Board and the middle management.

- In FR, Articles L. 225-69-1, L. 225-18-1, and L. 226-4-1 of the French Commercial Code provide that (i) the proportion of members of the Board of each sex cannot be lower than 40%, and (ii) Board of directors with a maximum of eight members must limit the gap between the number of male board members and female board members to two. This requirement applies to:
  - Publicly listed companies on stock exchanges; and
  - Companies which, at the end of the next general meeting called to vote on appointments, for the third consecutive financial year have (i) at least 250 permanent employees; and (ii) a net turnover or balance sheet total of at least 50 million euros.

These thresholds apply from January 1st, 2020 (and therefore the first financial year to be taken into consideration for these thresholds is that of January 2017). Any appointment made in breach of these requirements which does not have the effect of remedying the irregularity in the composition of the Board shall be null and void.

- In IT, the so called T.U.F. (Legislative Decree n. 50 of February 24, 1998) has been recently amended in the Articles 147-ter and 148 providing that the percentage of the women to be present in the Board of Directors of listed companies is equal to 40% of the Board members;

- In PT, a minimal representation of 40% of each gender in the board must be ensured.
As concerns other jurisdictions considered, in **ES** there is not a legal obligation regarding the representation of the gender in the Board of Directors for listed companies.\(^{363}\) While in **NL**, a provision of law was in force until 1 January 2020, therefore, as of 1 January 2020, Dutch law does not contain a male/female-quorum.\(^{364}\)

In **FI**\(^{365}\) and **PL**, no legislation has been implemented that contains a provision with percentual requirement for gender balance in listed companies.

### 7.5.2.2 Market practices

Although the web-survey provides only limited evidence concerning market practices, the following points can be highlighted:

- **Presence of board members with competence in sustainability matters**, the **limited evidence provided by the survey is mixed**. On the one hand, directors with competence in sustainability matters sit in the board room of most companies that replied to the survey (85.7%, \(n=6\)).\(^ {366}\) On the other hand, when asked to what extent company boards include members with competence in sustainability matters, the majority of respondents from both business associations and investors replied from moderate to no extent (66.7%, \(n=6\) and 76.9%, \(n=10\), respectively).\(^ {367}\) Based on feedback collected, no specific differences can be observed in terms of country and sector.

- **Specific aspects of sustainability covered by competent board members**, there are **no remarkable differences as regards the extent to which the different sustainability aspects** (i.e. environmental, social, governance, economic) are covered. Based on survey replies given by companies, social sustainability is the most covered aspect \((n=6\) of 8 respondents to the question), followed closely by governance \((n=5)\), environmental \((n=4)\), and economic sustainability \((n=4)\).\(^ {368}\)

### 7.6 Stakeholder involvement

#### 7.6.1 Evidence from the literature

The literature review highlighted one factor that contribute to short-termism: stakeholders’ involvement in corporate decision-making.

The following section analyses in detail this factor by firstly illustrating how it relates to short-termism, and then presenting the key supporting evidence retrieved from the documents analysed.

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\(^{363}\) The Spanish Good Governance Code for Listed Companies, issued by the National Securities Market Commission (that includes recommendations for listed companies) states on its Recommendation 14 that the policy of selection of members of the Board promotes the objective that on 2020 the number of women members represents, at least, 30% of the total members of the Board. Additionally, please consider that there is a project of amendment of such Code and Recommendation currently in process stating that the number of the less represented gender in the Board entails, at least, 40% of the total members of the Board.

\(^{364}\) The Dutch Civil Code stated that the seats of the management board and the supervisory board of large public limited companies (naamloze vennootschappen) and large private limited liability companies (besloten vennootschappen met beperkte aansprakelijkheid) must be balanced with a distribution of at least 30% by women and 30% by men, insofar these seats are distributed among natural persons. The law did not provide for a penalty if the quorum was not met, but an explanation had to be given in the management report for non-compliance with the quorum ("comply or explain"). The articles were reinstated for a limited period of time and expired by operation of law on 1 January 2020.

\(^{365}\) The act on equality between women and men, requires that the board of a company in which the Government or a municipality is the majority shareholder, must have an equitable proportion of both women and men, unless there are special reasons to the contrary. There is no strict percentage limit.

\(^{366}\) Q46 – Does your company board include members with competence in sustainability matters?

\(^{367}\) Q51 – To what extent do the boards of companies include members with competence in sustainability matters?

\(^{368}\) Q47 – If yes, what are the aspects of sustainability that they cover?
Stakeholders’ involvement in corporate decision-making

How does this factor relate to short-termism?

Recent research\textsuperscript{369} suggest that there is a strong business case for stakeholder engagement, as this practice allows companies to (1) protect license to operate by building reputation and credibility, (2) anticipate emerging risk by understanding stakeholder concerns, and (3) improve problem-solving and decision-making by hearing a diverse range of perspectives and expertise.

Many empirical studies highlight the various positive effects of stakeholder involvement in corporate decision-making. Stakeholders’ participation in decision-making has been linked to improved efficiency leading to competitive advantage,\textsuperscript{370} protection of long-term investment in firm-specific human capital,\textsuperscript{371} more efficient use of information and effective communication,\textsuperscript{372} and reduced conflicts,\textsuperscript{373} as greater stakeholder involvement lays the ground to turn “distrustful opponents into critical friends”.\textsuperscript{374} Moreover, Eccles et al. (2012) show that companies that have organised procedures for stakeholder engagement are more long-term oriented, exhibit more measurement and disclosure of non-financial information, and significantly outperform their counterparts over the long term, both on the stock market and in accounting performance.\textsuperscript{375} Meaningful stakeholder engagement (to identify actual or potential adverse impacts, devise prevention and mitigation responses to risks, identify forms of remedy for adverse impacts caused or contributed to by the enterprise and when designing processes to enable remediation, etc.) is also recognised as important in the OECD Due Diligence Guidance for Responsible Business Conduct.\textsuperscript{376}

Literature review show that limited stakeholder involvement in board decision-making can be related to short-termism. Boards’ excessive focus on the short-term performance is a response to market expectations and pressure from investors.\textsuperscript{377} On the opposite, stakeholders (other than shareholders) have a greater interest in promoting the long-term sustainability of companies than investors and executives. Poor cooperation with key internal (in particular employees) and external stakeholders (in particular the investors) prevents corporate boards from striking the right balance between short and long-term corporate objectives and countering short-termism more effectively. By providing employees with greater involvement in board discussion and decision-making process, corporate boards could give a “voice” to a value creator of the company and further improve strategic planning and risk mitigation, striking a reasonable balance in the firm’s pursuit of maximising profits and valuing social capital.\textsuperscript{378} In particular, employees have a stake in the future of the company they work for, in the sustainability of their working conditions as well as of the products and services they produce. Moreover, they are uniquely qualified to identify problems and possible solutions within the production process and

\textsuperscript{369} SustainAbility (2018), Common Threads: Designing Impactful Engagement.


\textsuperscript{376} OECD (2018), cit.

\textsuperscript{377} EY (2014), cit.

\textsuperscript{378} WBCSD (2019), cit.
organisation.\(^{379}\) For these reasons, larger employee involvement in the board decision-making can be linked to a better safeguarding of the long-term interests of corporations. Employees tend to have a long-term perspective because they make illiquid investments in the companies for which they work. “As the interests of employees are aligned with those of the corporation as an on-going enterprise and with the creation of economic prosperity in the long-term, endeavouring to include employees in corporate governance can therefore help corporations to counterbalance pressure from capital markets and short-term investors, in particular against opportunistic hostile takeovers and buyouts.”\(^{380}\) Moreover, an empirical analysis of sustainability data for large European listed companies found that employee representation is positively associated with better social and environmental performance by companies, and that companies with stronger employee involvement on average are more sustainable than those without employee participation.\(^{381}\) These findings support the link between greater stakeholder (namely employees) involvement in decision-making and corporate sustainability.

Despite this, a persisting asymmetry exists between shareholders and other stakeholders when it comes to corporate decision-making. Stakeholders other than shareholders are in many ways affected by the actions (and non-actions) of companies, to the point that their financial well-being even depends on the company’s (long-term) success (as in the case of employees and suppliers). At the same time, however, some stakeholders (such as employees and customers) are also instrumental for the survival of the company.\(^{382}\) as they provide the business with essential resources.\(^{383}\) Nonetheless, especially in the Anglo-American tradition of corporate governance, stakeholders have not been given a voice in corporations.\(^{384}\) In absence of a general obligation for company boards to actively involve stakeholders in their decisions, this would happen only on discretionary basis, and stakeholders “must simply hope corporate leaders will consider their organisations’ extensive effects and act responsibly toward all affected groups”.\(^{385}\)

**Supporting evidence**

**Stakeholders’ involvement in corporate decision-making on voluntary basis is rather limited.** Although the literature review did not reveal a substantial body of studies on this matter, a 2010 empirical study\(^{386}\) covering 46 businesses (including European ones) voluntarily granting stakeholders access to corporate decision-making through various mechanisms finds that the majority of stakeholder governance mechanisms provide stakeholders with very limited influence in decision-making. Only in a minority of corporations considered (26%) stakeholders were granted a significant influence in corporate decision-making. Moreover, stakeholder engagement mechanisms granting stakeholders the highest scope and power in decision-making typically involved one specific group of stakeholders, the customers. The study concludes that “it is not enough to remain at the stage of dialogue and issues advisory where the real stakeholder impact usually remains unobservable. In order to make stakeholder governance sustainable, corporations also need to provide stakeholders with real power in order to address the issues which are important to them”.\(^{387}\)

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\(^{381}\) ETUI/ETUC (2014), Benchmarking Working Europe, ETUI, Brussels, p. 110.


\(^{385}\) Hale, K. (2003), cit., p. 825.


A typical mechanism to involve stakeholders in corporate decision-making is by providing employees with the right to be represented in the board of directors. Where this mechanism is present, it is typically mandated by the law (i.e. non-voluntary). The practice of providing employee representation in corporate boards is quite diffused in European jurisdictions. However, there is a minority of EU countries where employees are not entitled to be represented at board level. According to a study by the European Trade Union Institute (ETUI), employees are granted the right to be represented in the board of directors or the supervisory board of their company with decision-making power in most Member States, while in a minority of EU countries workers have no or very limited participation rights.

Box 11 – Employee representation in EU countries

Based on the existence of legislation or other arrangements for employee representation at board level (or lack thereof), EU28 countries can be divided into three groups:

- **Group 1 – No (or very limited) participation rights**: A group of 10 countries where there is no regulation on employee representation at board level (Belgium, Bulgaria, Cyprus, Estonia, Italy, Latvia, Lithuania, Malta, Romania and the United Kingdom). This does not mean that there are absolutely no employee representatives at board level in these countries. However, these are individual rather than generalised arrangements.

- **Group 2 – Limited participation rights (mainly in state-owned companies)**: A group of 5 countries where employee board-level representation is limited to state-owned, municipally-owned or privatised companies (private companies are excluded) (Greece, Ireland, Poland, Portugal and Spain).

- **Group 3 – Widespread participation rights (both in state-owned and private companies)**: A group of 13 states where employee representation at board level extends also to private companies, once they have reached a certain size (Austria, Croatia, Czech Republic, Denmark, Finland, France, Germany, Hungary, Luxembourg, the Netherlands, Slovakia, Slovenia and Sweden). These thresholds vary greatly as do other elements of the national arrangements:

In the latter group, both the thresholds for representation and the number of board seats taken by employee representatives vary greatly. For instance, in Germany, the supervisory board of a listed company with 501 to 2,000 employees must have employee representation equivalent to one-third of the board. For companies over 2,000 employees, representation must be one-half of the board. In France, one or two employee representatives must be appointed to the board if a company is located in France and has at least 1,000 permanent employees in the company and subsidiaries, or if a company is located on the French territory and abroad and has at least 5,000 permanent employees in the company and subsidiaries. In the Netherlands, if a company is made up of at least 50 employees, then the company must set up a works council, which may recommend candidates to the supervisory board.

Source: based on ETUI data, updated to 2017. available at: https://www.worker-participation.eu/National-Industrial-Relations/Across-Europe/Board-level-Representation

As can be observed from the box above, even among the Member States where employees are represented at board level with the right to vote (Group 2 and 3), there is a significant degree of institutional diversity across national settings, as employee representation depends on elements such as the characteristics of the type of company covered by the law (e.g. state-owned vs private), the characteristics of the boards on which employee directors sit (e.g. one-tier vs two-tier boards), the way employee directors are nominated and appointed, and the way legal provisions are implemented.

As a way to promote long-termism, therefore, there is room to extend board-level representation of employees to EU countries where it is not currently foreseen and to set EU-wide minimum standards on employees’ representation common to all.

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392 In recent years, the establishment of a common EU framework on information, consultation and board-level
As concerns other stakeholders, the literature review could not identify any comprehensive survey of practices for stakeholder engagement and involvement (including at board level) currently implemented by companies in EU, even though specific best practices could be identified across different sectors. The engagement of stakeholders (other than employees) appears to be very company-specific and can take many forms, from partnerships with NGOs, to formal community engagement programs or advisory bodies.\textsuperscript{393} For stakeholder engagement to lead to a remarkable extension of corporate accountability, there needs to be some mechanism by which stakeholder views can feed directly into corporate decision-making. Based on the literature review, there are no practices allowing stakeholders (other than shareholders and employees) to appoint directors and be represented at board level. The literature highlights that an advisory body can provide representation for stakeholders through a “second tier” within the governance structure.\textsuperscript{394} By serving as a proxy of different stakeholder groups, an advisory body (ideally chaired by a non-executive director) can ensure that the board gets a broad sense of outside perspectives on the company and of concerns for its sustainability impacts. A few instances of advisory bodies/panel involving external stakeholders have been identified, but is not clear, based on information available, if they are given direct access to the board and to what extent they are able to effectively influence corporate decision-making.

\textbf{Main issues}

- Greater stakeholder involvement in decision-making can help companies to counterbalance pressure from capital markets and short-term investors and give “voice” to subjects with a strong interest in the long-term sustainability of the company. However, stakeholders’ involvement in corporate decision-making is still limited and patchy across jurisdictions.

7.6.2 \hspace{0.5cm} \textbf{State of play in 12 EU Member States}

7.6.2.1 \hspace{0.5cm} \textit{Regulatory framework}

\textbf{None of the 12 Member States provide measures for the involvement of company’s creditors, clients and third parties in the decision-making processes.} They only have the right to hold the Board or the companies accountable in case of damage suffered (see section 7.7.2.1)

\textbf{Only shareholders and employees have the right to be involved in the management of the company during its life.}

More specifically, with reference to shareholders, in all 12 Member States (with no difference for size, sectors and listed and unlisted companies), director’s decisions shall tend to guarantee the protection of the company’s interest and, therefore, shareholder’s interests. For example, shareholders have the right to set in place the following procedures:

1. \textit{Stop loss procedure}: when the company’s equity is below a certain threshold, the general shareholders’ meeting must decide if they want to dissolve the company or which actions they will take to carry on.

2. \textit{Repurchase of shares}: no repurchase is possible if the equity will drop below a certain threshold.

3. \textit{Capital decrease}: the articles of association need to be amended and published, the stakeholders can claim collateral, and some other formalities.

representation rights for employees has been advocated also by the ETUC as mean to promote the smart growth and long-term interest of EU companies while creating a level playing field. ETUC (2016), ‘Orientation for a New EU Framework on Information, Consultation and Board-Level Representation Rights’, ETUC Position Paper. Available at (link).

\textsuperscript{393} IFC (2009), \textit{Stakeholder Engagement and the Board: Integrating Best Governance Practices}, Global Corporate Governance Forum Focus 8, p. 38. Advisory bodies are particularly helpful in extractive industries, where a standing advisory body can serve as representatives for local communities impacted by mines or drilling, creating a forum to facilitate communication and address sustainability concerns.

\textsuperscript{394} IFC (2009), \textit{cit.}, p. 49.
On the other hand, employees are the only category that the law of few Member States expressly take care of as relevant stakeholders (other than shareholders). Employees are in particular involved in:

- **Representation and decision-making at board level in DE, FI, HU and SI:**
  - In **DE**, companies with more than 2,000 German-based employees subject to co-determination must have employees and union representative filing 50% of the seats on the supervisory board with the chairs having casting vote.
  - In **FI**, in undertakings employing regularly at least 150 employees, personnel have the right to participate in the decision-making. The right to participate (if not otherwise agreed to in a contract between the employer and employee representatives) gives personnel the right to appoint representatives to the board of directors or other similar decision-making bodies. If not otherwise agreed personnel's representatives are entitled to vote on matters not related to nominating executives, their pay or contract terms, employee contracts or industrial actions.
  - In **HU** if the annual average number of full-time employees employed by the company exceeds 200, one third of the supervisory board shall be made up of employee representatives. They are, besides, entitled to participate at the meeting of the supervisory board and to vote in the decision-making process.
  - In **SI** the employees have the right to be informed, to give their opinions and to be included in the decisions for matters directly affecting them. In addition, workers' participation in in the Board of Directors shall be exercised by the representatives from workers in the Management or Supervisory Board of the company, namely:
    1. in the two-tier system of governance, employees are represented by workers' representatives in the Supervisory Board or the and possibly also by workers' representatives in the Management Board;
    2. in a one-tier system of governance, employees are represented by workers' representatives on the Board of directors as well as by workers' representatives being executive directors of the company.

- **Representation and consultation at board level in FR:**
  - In **FR**, in companies with at least 50 employees, two members of the workers representative ("comité social et économique") may attend all board meetings but only with a consultative capacity. Please note there are also workers representative in shareholders meetings. Moreover, the French Duty of Vigilance Law requires companies to develop their vigilance plan in association with their stakeholders (including employees) and establish an alert mechanism on sustainability risks in consultation with the representative trade unions.

Overall, with few exceptions described above (for the employees of large companies) **there are neither provision of company laws nor self-regulatory measures which expressly tend towards the involvement of stakeholders (other than shareholders) in the decision-making processes** and definition and implementation of sustainability corporate governance measures. Therefore, a persisting asymmetry exists between the protection shareholders and other stakeholders when it comes to corporate decision-making and their representation in the Board of directors.

### 7.6.2.2 Market practices

Although the web-survey provides only limited evidence concerning market practices, the following points can be highlighted:

- **Stakeholder involvement in decision-making:** the evidence regarding the actual involvement of stakeholders (other than shareholders) in companies’ decision making is mixed. Considering together the answers of companies, business associations and investors (that replied with reference to the companies they represent and invest in, respectively), there is a majority who observe stakeholder involvement in decision-making
As regards other stakeholder categories consulted, the majority of trade unions (60%, n=6) replied that stakeholders are involved in company decision-making, while almost all NGOs (87.5%, n=7) reported that this is not the case. Interestingly, in the case of Germany, trade unions and NGOs from the same country expressed opposite views on this topic. Based on feedback collected, no specific differences can be observed in terms of sector and company size.

- **Categories of stakeholders (other than shareholders) involved in decision-making**: considering all answers received, employees stand out as the stakeholder category most involved in corporate decision-making (n=28 of 57 respondents to the question), followed by customers (n=9), local communities (n=7), NGOs (n=6), suppliers (n=6), and global communities along the business value chain (n=5). DE, FR, NL and SE are the countries where most respondents selected employees as stakeholder category, which is consistent with their national regulatory frameworks (e.g. co-determination in DE). Based on feedback collected, no specific differences can be observed in terms of sector and company size.

- **Stakeholder involvement in the implementation of the sustainability strategy**: the majority of companies that replied to the survey report that stakeholders are involved in the oversight (60%, n=3) of the corporate sustainability strategy. Considering the design of the sustainability strategy, half of the companies replied yes (50%, n=3). Quite different is the position of respondents from business associations and NGOs. In particular, the large majority of NGOs taking the survey reported that stakeholders (other than shareholders) are not involved in the design of a sustainability strategy (85.7%, n=6), and the totality of NGOs agree that there is no stakeholder involvement in oversight (100%, n=8). Based on feedback collected, no specific differences can be observed in terms of country, sector and company size.

- **Establishment of fora for stakeholder engagement**: there is evidence that specific fora for stakeholder engagement have not yet been established in most companies. Considering all answers received, the majority of respondents reported that companies have neither created advisory body (65.7%, n=21) nor convened stakeholder consultation meetings (65.7%, n=21). In terms of sector, the chemical industry is the only one that stands out for stakeholder engagement practices (n=4). Although this might be due to the fact that the chemical industry is more represented than other sectors among respondents, it is nonetheless in line with the finding that good practices of stakeholder involvement exist in the chemical sector (see the case of the German Chemical company BASF). Based on feedback collected, no specific differences can be observed in terms of country and company size.

### 7.7 Enforcement

#### 7.7.1 Evidence from the literature

The literature review highlighted one factor that contributes to short-termism: stakeholders’ rights to hold the board or its members accountable.

The following section analyses in detail this factor by firstly illustrating how it relates to short-termism, and then presenting the key supporting evidence retrieved from the documents analysed.

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395 Q58 – Are stakeholders (other than shareholders) involved in companies’ decision-making?
396 Q59 – If yes, could you please specify what categories of stakeholders are involved?
397 Q60 – Are stakeholders (other than shareholders) involved in the design and/or oversight of the sustainability strategy?
398 Q61 – Have companies established specific fora for stakeholder engagement?
Stakeholders’ rights to hold the board or its members accountable

How does this factor relate to short-termism?

As explained in section 7.1, directors are under a duty to act in the interest of the company as a whole. As matter of law, board members have the discretion to take account of any stakeholder interest they consider will promote the interests of the company as a separate entity, even if this will not maximise shareholder value in the short-term. In doing so, directors are protected in nearly all jurisdictions by some version of the business judgement rule.\textsuperscript{399}

In practice, however, even though the duty to act in the interest of the company does not mean serving exclusively the financial interest of the shareholders, directors might find themselves pursuing the objective of maximising the short-term shareholder value. This is not due to a specific legal obligation, but because of the pressures imposed by financial markets, activist shareholders, the threat of a hostile takeover, and stock-based compensation schemes.\textsuperscript{400} This situation is likely to have a limiting effect on the discretion that directors have in considering other stakeholder interests and the long-term corporate sustainability in their business decisions. Since shareholders are in most cases the only constituency given enforceable rights for an alleged breach of directors’ duties, and considering that the most active shareholders (such as mutual funds or hedge funds) tend to have a short-term focus and to “pressure directors and executives to pursue myopic business strategies that don’t add lasting value”,\textsuperscript{401} this state of affairs could negatively affect a board’s ability to define a long-term business strategy that is both profitable for shareholders and respectful of the company’s employees, consumers, communities, and the environment.

In this scenario, the absence of the possibility for stakeholder groups to sue board members for not considering their interests deprives stakeholders of any incisive instrument to effectively influence business decisions and protect their interests. Even though directors can take account of stakeholder interests in pursuing the interest of the company, the enforcement of the directors’ duty to act in the interest of the company is generally limited to the board of directors (or the supervisory board in two-tier systems) and to the shareholders (see below for a review of the situation in EU). In most jurisdictions, stakeholders of the company other than shareholders, who contribute and are interested in corporation’s long-term success (such as the creditors, the employees, etc.) as well as communities impacted by the operations of the company (e.g. local communities, communities across the global value chain, etc.) lack legal standing to sue the board or board members on behalf of the company for decisions neglecting their interests.\textsuperscript{402} This means that stakeholders groups lack a right to bring a claim against directors for an alleged non-consideration of their interests. Since they lack standing to enforce the duty, the enforcement of their interests seems unlikely, as de facto it depends on the discretionary choice to litigate of the board of directors and/or the shareholders, i.e. the only two groups that have standing to enforce the duty. In all jurisdictions, they are still allowed to bring a claim against directors in their own right (i.e. not on behalf of the company), but only in case they suffered a direct damage as a consequence of a directors’ action or omission (committed either lawfully or in breach of law).

Without legal standing to enforce directors’ duties, stakeholders lack the means to effectively ensure the protection of their legitimate interests in corporate activities. As pointed out by Strine with reference to the US situation, even if corporate law grants directors the authority to give other constituencies equal consideration to shareholder, the accountability structure within which they operate is tilted heavily in favour of one specific constituency, the shareholders,

\textsuperscript{399} Stout, L.A. et al. (2016), cit. The “business judgement rule” means that the director is not liable for breaching its duty of care to the company if the director has made the business decision based in good faith and on adequate and appropriate processes and information concerning the matter.

\textsuperscript{400} Stout, L.A. et al. (2016), cit.


\textsuperscript{402} The only exception to this general rule is employees in Germany, where the employees have the right to take legal action against the director of a limited company (GmbH) in case the obligation to take due care has been violated (see section 7.7.2.1).
which is the only constituency given any enforceable rights, and thus the only one with substantial influence over the board.\textsuperscript{403}

**Supporting evidence**

A 2013 study on directors’ duties and liabilities\textsuperscript{404} in EU28 found that, despite a significant degree of variation in the specific content of the provisions across the domestic frameworks, in EU countries the board members’ duty to act in the interest of the company can in general be enforced only by the board of directors, supervisory board (in two-tier systems) and/or by the shareholders in the general meeting. These are the only actors empowered to instigate legal proceedings against the directors on behalf of the company for an alleged breach of directors’ duties.

Based on the few studies\textsuperscript{405} available on the matter, current level of enforcement of directors’ duties are low in all Member States, i.e. litigation brought by the company against board members for alleged breaches of the duty of care is rare. According to the study mentioned, this can be explained by the fact that the board is unlikely to sue one of its members on behalf of the corporation. Even in two-tier board systems, where management and oversight functions are separated, supervisory board members might be reluctant in bringing actions against management board members, as this would entail admittance of a breach of the supervisory boards’ duty to exercise control over the management. Moreover, even where shareholder litigation is possible, individual shareholders have limited incentives to bring a suit against a director. They would have to bear the costs of starting and carrying on the suit, while the benefits would accrue proportionally to all other shareholders as well. Finally, considering the uncertain likelihood of success, the decision to litigate might not always be in the interest of the shareholders as a group, as it might generate negative publicity around the company, reducing sales and wasting the time of executives. For these reasons, suits against directors for alleged breach of the duty to act in the interest of the company remain rare in Europe.

It is notable that, to address the low level of enforcement of directors’ duties, different legal initiatives and interpretations have been put forward, both in EU and beyond\textsuperscript{406} although in no case these proposals go as far as recognising specific rights to stakeholders for holding the board or board member accountable for their decisions, even when they have a legitimate interest in the company’s future sustainability. As described in Box 12, there are non-EU jurisdictions where board members can be sued for the negative impacts resulting from company’s misconduct (i.e. a conduct has occurred which is oppressive, unfairly prejudicial or unfairly disregards the complainant’s interests), and where national regulatory bodies have the power to bring proceedings against the executive directors.

<table>
<thead>
<tr>
<th>Box 12 - Enforcement in third countries</th>
</tr>
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<tbody>
<tr>
<td>In Canada, the oppression remedy enshrined in the Canada Business Corporations Act (Art. 241) provides that a complainant can bring an application against a corporation or director where conduct has occurred which is oppressive, unfairly prejudicial or unfairly disregards the complainant’s interests. If the complainant is successful, this may lead to direct compensatory</td>
</tr>
</tbody>
</table>

\textsuperscript{403} Strine Jr, L.E. (2014), cit.
\textsuperscript{406} For instance, the draft Accountable Capitalism Act in the US and the French "Devoir de Vigilance" Law passed in February 2017. In the Netherlands, based on the Civil Code (Articles 2:344-2:359), the Enterprise Chamber of the Amsterdam Court of Appeal has broad powers of investigation and intervention in the internal affairs of companies, including nullification of resolutions and decisions, suspension, dismissal or appointment of directors, and other remedies including dissolution. See Van Bekkum, J., Hijink, S., Schouten, M.C., Winter, J.W. (2010), 'Corporate Governance in the Netherlands', Electronic Journal of Comparative Law, Vol 14.3.
Study on directors’ duties and sustainable corporate governance

damages, dissolution of the corporation, amendment of the corporation’s by-laws. Besides current and former directors and shareholders, any other person who, in the discretion of a court, is a proper person to make an application can be a complainant, which means that also NGOs and employees can bring a complaint, at least virtually. Moreover, the Canadian Environmental Protection Act (Art. 280) provides that, when a company fails to prevent environmental contraventions through reasonable care, directors can be personally liable for directing, authorising, participating in, or acquiescing to, that conduct (regardless of whether the company is charged or convicted).

In a similar way, in Norway, any person or entity having suffered negative impacts (measurable in economic terms) due to actions of the company, can sue inter alia members of the board, a shareholder, auditor, or general manager. The Australian Securities and Investments Commission has power to bring proceedings in the public interest against directors for breach of disclosure regulations and breach of duty, especially where necessary to restore market confidence and integrity.

The main issues emerging from the literature review

- Stakeholders other than shareholders, such as the creditors, the employees, local communities, etc., lack legal standing to sue the board or board members on behalf of the company for decisions neglecting their interests. This prevents them from enforcing the directors’ duty of care, even when they have a legitimate interest in the long-term sustainability of the company.

7.7.2 State of play in 12 EU Member States

7.7.2.1 Regulatory framework

In all Member States, directors’ duties are owed to the company, i.e. to the legal entity and not to the shareholders, which implies that directors are liable towards the company for a breach of their duties. By virtue of this principle, enforcing directors’ duties means enforcing a company’s claim, i.e. an action brought on behalf of the company against a director for an alleged breach of its duties towards the company (not the shareholders). The enforcement of the company’s claims is not linked to any other interest than the interest of the company itself.

In all 12 Member States covered in this legal review, the organs authorised to act on behalf of the company in enforcing director’s duties are either the board, the supervisory board, or the shareholders through the general meeting. More specifically:

- In BE, general shareholder meeting has exclusive power to bring a liability claim against a director (actio mandati). The board of directors or a specially appointed agent represents the company in the proceedings;
- In DE, the supervisory board has the authority to act and represent the company. The shareholders meeting can require enforcement by simple majority;
- In ES, and SE, the general shareholder meeting has the authority to act on behalf of the company and represent it;
- In FR, FI and NL the board of directors has the authority to act and represent the company;

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- In **HU**, decision on enforcing the claim is supposed to be passed by the general shareholder meeting but there are no specific rules covering representation. No specific rights of representation allocated to supervisory board;

- In **IT**, the board of directors can act in representation of the company, while shareholders can direct the board to commence litigation by ordinary resolution. However, even the Board of Statutory Auditors by two-thirds majority has the power to act. Under the two-tier model, the company’s claim could be enforced either by the supervisory board or through shareholder resolution.

- In **PL**, the shareholders general meeting decides on the enforcement of company’s claims. The respective director is excluded from participating in the vote if he/she is also shareholder. In the judicial proceedings, the company is represented either by the supervisory board or by a special attorney appointed by the general meeting;

- In **PT**, general shareholder meeting has the authority to act. However, upon the request of shareholders representing at least 5% of the share capital, the court appoints a special attorney to represent the company in the action;

- In **SI**, the general shareholder meeting, by simple majority, has the power to resolve upon the instigation of legal proceedings against the directors. The chairman of the supervisory board, or a special representative, represents the company in the proceedings.

However, **directors can be liable to shareholders and other stakeholders (such as creditors and employees) for acts (or omissions), either lawful or in breach of the law, as a result of which they suffered damages and/or losses.** In such cases, the claims against directors are brought by the shareholders and the stakeholders (not on behalf of the company) and are directly linked to the damage and/or losses suffered by them. As highlighted also in the literature, personal claims do not raise particular problems in EU jurisdictions.\(^{410}\)

In particular, **directors are personally liable (i) toward shareholders and (ii) stakeholders (other than shareholders) in the following cases:**

**(i)** **Liability toward shareholders in most Member States (PL, SI, FR, HU, IT, BE, PT, SE, ES and FI) takes place when shareholders are damaged by directors’ behaviours.** For instance:

- In **BE**, when the behavior (mistake, breach, carelessness) of the board caused damage to a shareholder, the shareholder can sue the board (member) and demand a contribution.

- In **FR** a shareholder can engage the civil liability of the directors because of the existence of a social injury (*ut universi action*) or because he suffered an injury distinct from the one of the company (*ut singuli action*). The shareholder has to demonstrate the existence of a fault of the board (offense committed in the management, violation of a legal and regulatory provision or violation of articles of association), a damage and a link between the fault and the damage.

- In **HU** the liability of directors against shareholders is limited to the following case. Once the company is wound-up, claims for damages may be brought against the director by the shareholders registered at the time of the company’s removal from the registry, within a period of one year following the time of removal. Furthermore, it is the shareholder’s right to withdraw the directors in case of any breach of the director’s responsibility.

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\(^{410}\) Personal claims are actions brought by shareholders or third parties in their own name for the infringement of individual rights owed directly to them. Enforcement of such rights generally does not pose problems. By definition, personal claims are characterised by a loss suffered by the claimant (shareholder or third party) personally and not shared with other shareholders (or third parties). In addition, they arise from duties owed directly to them and not to the company, as the duty of care. See Gerner-Beuerle, C., Paech, P., Schuster, E.P. (2013), cit., p. 184.
(ii) Liability toward stakeholder (creditors, employees, clients etc.) in all Member States (PL, NL, DE, SI, FR, HU, IT, PT, BE, SE, ES and FI)\textsuperscript{411} takes place only in case of directly damage caused to stakeholders. For example:

- In **BE**, stakeholders can sue directors when the actions of the latter cause damage to a stakeholder; the action can be taken both for material and indirect damage, such as moral damage, reputation damage and loss of profit. There has to be a link between the damage and the behaviour of the director.

- In **DE**, Sec. 823 of the German Civil Code provides an opportunity for third parties (other than the company) to make a claim against the directors in case the stakeholders have suffered losses. However, this is only possible if and as far as, the claim cannot be made against the company itself. In addition, the employees have the right to take legal action against the director of a limited company (GmbH) in case the obligation to take due care has been violated, i.e. in case the management has violated its duty to manage the affairs of the company with the “diligence of a prudent businessman”.

- In **FR**, a stakeholder, other than a shareholder, can sue for civil liability the board members demonstrating the existence of a damage, of a gross negligence and of a link between the fault and the damage. Moreover, the French Law on the Corporate Duty of Vigilance (law No. 2017-399 of 27 March 2017) provides that the company’s vigilance plan (i.e. covering items like risk mapping, regular assessment procedures, appropriate actions for mitigating risks or preventing serious breaches, warning and reporting mechanisms, monitoring processes to assess the effectiveness of the measures implemented) shall be drafted in association with the company’s stakeholders, and where appropriate, within multiparty initiatives that exist in the subsidiaries or at a territorial level. The Law provides three judicial mechanisms to ensure and control the effective implementation of the duty of vigilance: a formal notice to comply (\textit{mise en demeure}), an injunction with periodic penalty payments (\textit{astreintes}) (i.e. injunctive fines payable on a daily or per-event basis until the defendant satisfies a given obligation), and a civil liability action in case of a damage. These mechanisms are available to any party with standing, including stakeholders whose rights and obligations are affected by the execution or the failure to comply with the duty of vigilance, for example local communities, employees, consumers, trade unions, associations or NGOs. It will be up to the claimants to prove a company’s breach – a lack of reasonable vigilance – , damage and a causal link.\textsuperscript{412}

- In **HU**, directors are liable toward stakeholder jointly with the company if the director acts in connection with his position.

- In **IT** and **PT**, the stakeholders have the right to take actions of responsibility towards directors in case said directors damage them adopting decisions not compliant with the obligations inherent in preserving the integrity of the corporate assets.

- In **NL**, directors’ liability is divided between liability towards the company and liability towards third parties. There is no provision which defines directors’ liability towards shareholders. Moreover, the Dutch Child Labour Due Diligence Law,\textsuperscript{413} approved by the Dutch senate on May 14\textsuperscript{th} 2019 (not yet in force), requires any company (either domiciled in the Netherlands or abroad) that delivers products and services to the Dutch end-users to submit a statement to regulatory authorities declaring that they have carried out due diligence related to child labour in their full supply chains. The statement shall made once and will be published on the website of the regulator. Complaints from interested stakeholders (e.g. trade union/NGOs) will trigger enforcement by a competent

\textsuperscript{411} This liability does not imply that stakeholders could directly sue the board or board members on behalf of the company for decisions neglecting their interests or damaging the long-term sustainability of the company, because this liability requires, first of all, that the stakeholder directly suffered a damage.


\textsuperscript{413} Information retrieved from [link].
authority, based on concrete evidence that the company’s products or services were produced with child labour. Any individual or entity wishing to submit a complaint must first submit the complaint to the company itself. If the company’s reaction is ‘inadequate’ according to the complainant, the complainant can escalate the case to the supervising regulator. The supervising regulator can issue a binding order to a company to comply with the act and set a deadline. Failing to comply with the regulator’s order can lead to administrative fines. \(^{414}\) If, within 5 years of imposition of an administrative fine, a similar transgression is committed by the company by order or under supervision of the same director, it is considered a criminal offense. \(^{415}\)

Based on the legal review, there are neither provisions of company law nor self-regulatory measures which expressly allow the stakeholders of a company to sue its directors for not having taken the stakeholders’ interests into account as part of their duty of care, even this could undermine the long-term viability of the company, and this because directors’ duties are owed to the company (not the shareholder nor any other stakeholder). However, in all Member States considered, stakeholders can bring a claim against directors in case a direct damage has been caused to them.

7.7.2.2 Market practices

Although the web-survey provides only limited evidence concerning market practices, the following points can be highlighted:

- **Directors’ liability towards shareholders**, the majority of companies taking the survey reported that directors are liable towards shareholders \((85.7\%, n=6)\). \(^{416}\)

- **Directors’ liability towards stakeholders** (other than shareholders), the majority of companies and business associations taking the survey reported that stakeholders (other than shareholders) are not entitled to hold company board and its members accountable for their decisions \((62.5\%, n=10)\). \(^{417}\) Companies and business associations replying that stakeholders are instead entitled to do so \((n=6)\) are located in FR, PT, and SE. It should be noted that, in a few cases, respondents from the same country provided contradictory answers, which undermines the reliability of the information provided. Based on feedback collected, no specific differences can be observed in terms of sector and company size.

- **Stakeholders entitled to launch a legal action against the board**, considering all responses received (from experts, trade unions, NGOs, legal practitioners and public authorities), employees are the most indicated stakeholder category \((n=11 of 26 respondents to the question), followed by local communities \((n=4)\), communities along the global value chains \((n=4)\), costumers \((n=4)\), NGOs \((n=4)\), and regulators \((n=4)\). \(^{418}\) Based on feedback collected, no specific differences can be observed in terms of country, sector and company size.

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\(^{414}\) The supervising regulator can issue a binding order to a company to comply with the act and set a deadline. Failing to comply with the regulator’s order can lead to administrative fines: (i) up to €4,100 (or to €8,200) for non-compliance with the duty to file a declaration; (ii) up to €820,000 (or 10% of the company’s annual turnover) for noncompliance with the duty to conduct due diligence.

\(^{415}\) Punishment can be up to 2 years of imprisonment for the company’s director and a €20,500 fine.

\(^{416}\) Q62 - In your company are directors liable towards shareholders?

\(^{417}\) Q64 - In the companies are stakeholders (others than shareholders) entitled to hold the company board and the board members responsible for their decisions?

\(^{418}\) Q66 - What type of stakeholder, if any, is entitled to launch some legal action to enforce board mem’ers’ duty to act in the interest of the company?
7.8 Non-financial reporting and disclosure

7.8.1 Evidence from the literature

The literature review highlighted one factor that contributes to corporate short-termism: disclosure of non-financial statements. The following section analyses in detail this factor by firstly illustrating how it relates to short-termism, and then presenting the key supporting evidence retrieved from the documents analysed.

Disclosure of non-financial statements

How does this factor relate to short-termism?

The disclosure of non-financial statements has been the major policy attempt to drive a more sustainable behaviour of companies, but part of the literature do not consider it sufficient alone to support change. On the one hand, research shows that investors are increasingly interested in the value creation process and that there is an evident trend among successful corporations towards reporting on long-term value creation in relation to the interests of all key stakeholders (including shareholders, employees, creditors, suppliers, customers, communities, civil society organisations and the environment). This is supported by the studies that highlight how corporations with a good ESG performance and reporting outperform their peers on the stock market and benefit from the lower cost of capital.

On the other hand, it has been argued by scholars that sustainability reporting, without strong enforcement and external verification measures, risks being used by companies as a system to simply improve their public image, without a real commitment to sustainability (the so-called “green-washing”). The obligation to publish non-financial and diversity information might risk fostering a culture of reporting instead of a culture of commitment and engagement. In spite of good intentions of bringing sustainability concerns into the boardroom, and much hard work in this area, reporting requirements have so far proven to be insufficient to overcome pressures for short-term shareholder value and to influence corporations and their investors to prioritise sustainability, as they are largely discretionary and lack verification requirements. For instance, neither the GRI Standards nor the EU Non-Financial Reporting Directive mandate the external verification for the selection of KPIs and related sustainability performance data. Research shows that companies are prone to selecting KPIs that are easy to report on and give a positive impression of the company. Consequently, the relevance and reliability of information disclosed in sustainability reporting is undermined.

Supporting evidence

At European level, the EU Non-Financial Reporting Directive introduced the requirement for large public companies and financial corporations operating in Europe to disclose information on environmental, social, human rights and anti-corruption matters, necessary for understanding the company’s development, performance, position and impact. A “comply or explain” approach applies to the policy aspects of non-financial disclosure. This implies that a company must state that it implements a policy covering each specific ESG factor or, if it does not have a policy in relation to a specific ESG factor, it must provide an explanation of why that is the case. Pursuant

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to the transposition of the Directive rules by the Member States, companies were supposed to include this “non-financial” information in their reports for the previous financial year for the first time in 2018.\textsuperscript{245} Even though the EU Non-Financial Reporting Directive unquestionably represents a positive policy development towards greater transparency, a recent research report\textsuperscript{246} by the Alliance for Corporate Transparency observed that it does not specify in sufficient detail what information and KPIs must be disclosed by the companies, nor the concrete sustainability issues to which they relate. The Directive leaves to companies the use of voluntary standards and frameworks for reporting, and the European Commission Guidelines\textsuperscript{247} that support the Directive indicate a large number of issues that can be considered in the reporting process.

The lack of sufficient details and the flexibility granted to companies in reporting led to lack of meaningful, comprehensive and comparable sustainability reporting by the companies. In turn, the general information that most companies provide does not allow investors and other actors to understand companies’ impacts and by extension their development, performance and position.

Other academic publications also underlined the lack of enforcement of Directive’s reporting requirements and of third-party verification of the information provided by companies as problematic aspects.\textsuperscript{248}

The quality and reliability of sustainability reports have been largely questioned in the literature.\textsuperscript{249} The disclosure of information on corporate sustainability performance, despite the efforts for standardisation, remains problematic due to observed inconsistencies that limit the quality and credibility of information. In this perspective, sustainability reports are often interpreted in the literature as marketing instruments, tools for social legitimisation or impression management strategies rather than as a source of reliable information for stakeholders.\textsuperscript{430} The “optimistic and auto-laudatory character of selective sustainability reports”\textsuperscript{431} has been highlighted in several studies.\textsuperscript{432} For some authors, sustainability reports do not meet the principles of balance, exhaustiveness and transparency, which questions their credibility.\textsuperscript{433}

On 30 January 2020, the Commission released an \textit{inception impact assessment}\textsuperscript{434} and on 20 February 2020 opened a public consultation \textit{in view of a revision of the Non-Financial

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425 The Directive requires that companies as a minimum the following information: (1) a brief description of the undertaking’s business model; (2) a description of the policies pursued by the undertaking in relation to those matters, including due diligence processes implemented; (3) the outcome of those policies; (4) the principal risks related to those matters linked to the undertaking's operations including, where relevant and proportionate, its business relationships, products or services which are likely to cause adverse impacts in those areas, and how the undertaking manages those risks; (5) non-financial KPIs relevant to the particular business. Although non-financial statements of all companies in the EU should meet the above-mentioned requirements, the Directive left Member States with flexibility to specify these rules. Some countries (e.g. DK and SE) opted to expand the scope of their application to smaller companies. Some countries (e.g. UK) requires disclosures to be made in the annual report, while others, such as DE, allow companies to provide the information in a separate report. Some countries (e.g. France) specified certain ESG aspects that should be included in companies’ reports.


427 C/2017/4234.


**Reporting Directive.** In line with the above-mentioned issues, the Commission inception impact assessment highlights the following problems to be addressed:

- Reported non-financial information is not sufficiently comparable or reliable;
- Companies do not report all non-financial information that users think is necessary, and many companies report information that users do not think is relevant;
- Some companies from which investors and other users want non-financial information do not report such information;
- It is hard for investors and other users to find non-financial information even when it is reported;
- Companies face uncertainty and complexity when deciding what non-financial information to report, and how and where to report such information (in the case of some financial sector companies, this complexity may also arise from different disclosure requirements contained in different pieces of EU legislation).

A model often mentioned in the literature for non-financial statements are the **GRI standards**, which provide detailed metrics against which to report.\(^{435}\) Based on a 2017 study involving more than 600 publicly traded companies,\(^{436}\) GRI standards are used by 37% of the surveyed companies, and among them 67% had a time-bound commitment to reduce GHG emissions. However, some scholars\(^{437}\) have argued that the GRI approach do not focus enough on problems such as **the biased use of the guidelines to hide or camouflage unsustainable business practices** or the lack of substantial commitment to sustainability,\(^{438}\) or its mainly retrospective (rather than forward-looking) reporting model.\(^{439}\)

### Main issues emerging from the literature review

- Sustainability reporting, without strong enforcement and external verification measures as well as serious commitment, risks being used by companies as a system to simply improve their public image, without a real commitment to sustainability;
- The lack of sufficient details in current sustainability reporting practices and the flexibility granted to companies in reporting led to the lack of meaningful, comprehensive and comparable sustainability reporting by the companies.

### 7.8.2 State of play in 12 EU Member States

#### 7.8.2.1 Regulatory framework

**Relevant EU regulatory framework**

Concerning the disclosure of non-financial statements, the Non-Financial Reporting Directive\(^ {440}\) requires (on a comply or explain basis) large public-interest companies with more than 500 employees (e.g. listed companies, banks and insurance companies) to disclose non-financial information. This includes policies on environmental protection, social responsibility and treatment of employees, respect for human rights, anti-corruption and bribery matters. The Directive provides flexibility for companies on how to disclose their non-financial information, which may be included in an annual non-financial statement to be presented either in the management report or in a separate document. Companies may base their

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\(^{435}\) GRI (2016), ‘GRI Standards’.


\(^{440}\) Directive 2014/95/EU.
Disclosure of non-financial statements

Pursuant to the EU Non-Financial Reporting Directive, all 12 Member States have the obligation to disclose an annual non-financial statement, which shall include, among other matters, the company's policies on environmental issues, including the specific due diligence practices and mechanisms to ensure effective compliance with these policies; if the company does not follow these guidelines, it must explain why and how it deviates (comply or explain principle).

In particular, in every Member State listed companies have the obligation to disclose the non-financial statements. More specifically the year-end report must contain the information about development, results of the company and a statement concerning sustainable corporate governance. In addition, companies should disclose on annual basis information regarding human rights, information on the fight against corruption and bribery and information on the company including company’s commitments regarding, among others, sustainable development.

Only in FR there is the obligation for a company to submit non-financial statements to a third party’s audit.

**Overall, with the exceptions described above** (listed/large companies that are subject to the EU Non-Financial Reporting Directive with a comply or explain mechanism), there are neither provision of laws nor self-regulatory measures which expressly tend towards the adoption of sustainable corporate governance reporting and disclosure measures.

### 7.8.2.2 Market practices

Based on the evidence available from the survey and the sectoral analysis (see Annexes I.3 and I.4), the following considerations concerning market practices in sustainability reporting can be drawn:

- **Disclosure of ESG-related risks:** most companies answering the survey report to disclose their approach to sustainability and their non-financial performances in the financial annual report (n=5 of 8 respondents to the survey). Based on feedback collected, no specific differences can be observed as concerns country, sector and company size.

- **Sustainability reporting frameworks:** As the Non-Financial Reporting Directive requires companies to report the “non-financial key performance indicators relevant to the particular business”; this leaves some interpretation space for the companies whether and how to report on their sustainability impacts or on their risks. Companies are encouraged to rely on recognised reporting frameworks, such as GRI Sustainability Reporting Guidelines, the United Nations Global Compact, the UN Guiding Principles on Business and Human Rights, OECD Guidelines, ISO 26000, and the ILO Tripartite Declaration, as well as to disclose information based on methodologies specified in specific legislation, such as the Product Environmental Footprint and OEF methods included in the annexes to Commission Recommendation (EU) No 179/2013. As concerns the frameworks in use by the

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441 European Commission (2017), Guidelines on non-financial reporting.
443 In DE the reporting is compulsory only for companies of more than 6 million of balance sheet total, 12 million revenues or 50 employees.
444 Q38 – In which document ESG-related risks are published or described?
445 2013/179/EU: Commission Recommendation of 9 April 2013 on the use of common methods to measure and communicate the life cycle environmental performance of products and organisations. The Product Environmental Footprint and Organisation Environmental Footprint are life cycle assessment methods that enable companies to identify for each product or an entire organisation: (i) the most relevant impacts; and (ii) their contributing processes and
companies, the **GRI reporting standards stand out as most in use by companies** answering the survey (n=5 of 8 respondents to the survey), followed by Carbon Disclosure Project (CDP) (n=2), and EU Eco-Management and Audit Scheme (n=1). The result that the GRI reporting standards are the most used in preparing non-financial disclosures is in line with the finding of the recent research report⁴⁴⁶ by the *Alliance for Corporate Transparency*, which analyses the non-financial statements of 105 companies operating in EU. There are no remarks in terms of country, sector or company size. As suggested by the in-depth sectoral analysis (see Annexes I.3 and I.4), **a greater gap in reporting sustainability risks and impacts** stems from the fact that **reports are in most cases drafted in accordance with various internationally recognised frameworks**, which suggest and are **focused on different KPIs** for the evaluation of the sustainability-related impacts and in some cases ask for the disclosure of information of at least two consecutive years, while for the monitoring and disclosure of sustainability risks there is not an equal level of maturity.

- **Disclosure of sustainability risks and impacts along the entire value chain**: the non-financial statement should also include information on the due diligence processes implemented by the company regarding, where relevant and proportionate, its supply and subcontracting chains, in order to identify, prevent and mitigate existing and potential adverse impacts. Evidence collected through the sectoral analysis suggests that **companies are currently focusing their disclosure on the activities of their assets and operations, without giving a complete overview of the risks and impacts along the entire value chain**. The sectoral documentary review and three interviews with sectoral business associations indicate that, at sectoral level, the *food*, *car manufacture* and *garment sectors* appear more mature than other sectors on this aspect.

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8 Detailed description of options

Options and the related measures are described in the following sections according to the specific driver they are related to.

8.1 Driver 1 – Directors’ duties and company’s interest are interpreted narrowly and tend to favour the short-term maximisation of shareholders’ value

Option A1

Level of prescription

- Non-legislative/Soft - Spread corporate governance practices through awareness raising activities

Key features and the functioning of the option and main stakeholders concerned

- Option A1 implies that the Commission launches an awareness-raising campaign (M1.1), addressed primarily to the European business community, with the objective of:
  1. Clarifying that, when acting in the interests of the company, directors should properly balance the following interests, alongside the interest of shareholders: long-term interests of the company (beyond 5-10 years); interests of employees; interest of customers; interest of local and global environment; interest of society at large;
  2. Promoting the principle that identifying and mitigating sustainability risks and impacts, both internal and external, is part of directors’ duty of care.

The campaign would be designed by the Commission in collaboration with a broad range of interested stakeholders (e.g. academics, think tanks and NGOs; national public authorities; national and EU business associations, and companies), which could play a role as partners in organising the campaign-related events and involving relevant audience. The campaign would be funded at EU level and would be implemented through multiple channels (e.g. conferences, roundtables, stakeholder meetings, etc.), as to ensure an extensive geographical coverage of EU territory.

Expected advantages and disadvantages of the option

- Advantages: M1.1 could help raise awareness in the business community about current misconceptions on company’s interest and on the ongoing debate on director’s duties and sustainability. It could promote a more correct and sustainability-oriented understanding of directors’ duties and the interests in which they have to be carried out, especially in SMEs and companies not already dealing with sustainability issues. In terms of feasibility, the implementation of the campaign should not present major obstacles, especially if the Commission engages relevant partners from different stakeholder communities and actively involves them in its realisation.
- Disadvantages: taken alone, M1.1 might be too weak to counterbalance the widespread social norm of shareholder primacy and move the focus of director’s duties away from short-term shareholder value maximisation. Directors are appointed by shareholders, who remain often interested in the maximisation of their profits over the short-term. An awareness campaign might difficulty result in modifications of the current understanding of the main concepts of company law, or such modification could be too slow, considering how deeply the shareholder primacy is entrenched in the corporate governance theory and practice, often also in corporate governance codes.

Similar initiatives in selected third countries

- In the UK, the research and engagement programme The Future of the Corporation by the British Academy, after publishing a series of reports defining the ‘Principles
for Purposeful Business’ will convene in 2020 a series of summits that highlight the need for purposeful business in solving some of the major social and environmental challenges facing society, including climate change, inequality, declining trust and technological disruption.\footnote{See \url{link}.}

### Option B1

#### Level of prescription

- Non-legislative/Soft - Foster national regulatory initiatives through recommendations

#### Key features and the functioning of the option and main stakeholders concerned

- Option B1 implies that the Commission prepares and publishes a recommendation that provides Member States with a uniform, EU-wide interpretation of directors’ duties and company’s interest \(^{(M1.2)}\). Following such interpretation, Member States would be recommended to:
  1. Clarify in their respective national frameworks that, when acting in the interests of the company, directors should properly balance the following interests, alongside the interest of shareholders: long-term interests of the company (beyond 5-10 years); interests of employees; interest of customers; interest of local and global environment; interest of society at large;
  2. Introduce in their respective national frameworks an explicit directors’ duty to identify and mitigate sustainability risks and impacts, both internal and external, connected to the company’s business operations and value chain.

Clarifying the fiduciary duties of directors – i.e. that directors need to take stakeholders’ interest into account alongside shareholders’ interest and to identify and mitigate sustainability risks and impacts – would enable and contribute to the implementation of a corporate due diligence duty to identify and mitigate external harm (e.g. adverse environmental and human rights impact).

The recommendation would not have binding force and would leave up to the Member States the choice of the instruments to implement these requirements in the most suitable way according to their respective national specificities.

#### Expected advantages and disadvantages of the option

- **Advantages:** \(^{(M1.2)}\), through the instrument of the recommendation, would provide Member States with the necessary flexibility to adapt recommended modifications to their national regulatory frameworks for company law and corporate governance, avoiding a one-size-fits-all legally binding EU intervention.
- **Disadvantages:** \(^{(M1.2)}\) might not be sufficiently demanding to be effectively implemented by Member States and to create the necessary level playing field in this area, both for Member States and companies. Thus, the risk could be that Member States choose either not to introduce suggested modifications into their respective regulatory frameworks, or provide a national interpretation allowing them to gain a competitive advantage against other Member States and to be more attractive for companies. This could hinder the achievement of the policy objectives and create even more confusion on the interpretation of key company law concepts.

#### Similar initiatives in selected third countries

| N/A |

### Option C1

#### Level of prescription

- Legislative/Hard - Set minimum common rules through EU legislative interventions

#### Key features and the functioning of the option and main stakeholders concerned
Option C1 implies that the Commission proposes a **new EU directive providing an EU-wide formulation of directors’ duties and company’s interest (M1.3)**, requiring directors to:

1. **Properly balance the following interests, alongside the interest of shareholders**, when acting in the interest of the company: long-term interests of the company (beyond 5-10 years); interests of employees; interest of customers; interest of local and global environment; interest of society at large
2. **Identify and mitigate sustainability risks and impacts, both internal and external**, connected to the company’s business operations and value chain.

The specific content and formulation of these requirements would be decided by the Commission with the support of relevant expert groups (e.g. the expert group on company law; Member States expert group on sustainable finance), after consulting interested stakeholders, in particular companies. Moreover, clarifying the fiduciary duties of directors – i.e. that directors need to take stakeholders’ interest into account alongside shareholders’ interest and to identify and mitigate sustainability risks and impacts – would be complementary to introducing an EU-level requirement for a corporate due diligence duty to identify and mitigate external harm (e.g. adverse environmental and human rights impact).

### Expected advantages and disadvantages of the option

- **Advantages**: M1.3 would ensure a harmonised interpretation of directors’ duties and company’s interest in all national regulatory frameworks, and would be in line with a number of initiatives aimed at weakening the shareholder primacy norm.\(^{448}\) It would reinforce the idea that the beneficiary of directors’ duties is the company, and that it is necessary that directors identify and manage sustainability risks and impacts as part of their duties. Moreover, providing a specific duty in this regard to directors implies also the possibility of sanctions in case of misconduct, thus creating pressure for compliance. A new definition of company’s interest would not mean to eliminate the consideration for shareholders, but to align the definition to the current challenges of companies and make companies better performing in the long-term, also for shareholders.

- **Disadvantages**: even if there are several initiatives that point to the need to clarify directors’ duties and company’s interest, the implementation of M1.3 could be problematic. Considering their different legal traditions and heterogeneous national legal frameworks, and the lack of EU-level measures addressing these aspects of company law, it might be difficult for the Member States to agree on a uniform interpretation of these concepts.

### Similar initiatives in selected third countries

- In the US, the Accountable Capitalism Act, proposed in the Congress, calls for companies to have the purpose of creating a general public benefit (i.e. a material positive impact on society resulting from the business and operations) and for directors to balance the pecuniary interests of shareholders with the best interests of persons that are materially affected by the conduct of the company.\(^{449}\)

### 8.2 Driver 2 – Growing pressures from investors with a short-term horizon contribute to increasing boards’ focus on short-term financial returns to shareholders at the expense of long-term value creation

**Option A2**

### Level of prescription

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\(^{448}\) Sustainable Companies Project, SMART, Modern Corporation Project, and Purpose of the Corporation Project.

\(^{449}\) See Section 5 of the Accountable Capitalism Act proposed by US Senator Elizabeth Warren ([link](#)).
### Key features and the functioning of the option and main stakeholders concerned

- **Option A2** implies that the Commission publishes a **green paper on long-term shareholder engagement and lengthening shareholding periods** (**M2.1**). The green paper, written with the support of ESMA, would discuss and illustrate possible measures to foster longer term shareholding, building on the results of the study by ESMA on short-term pressure by the financial market, and could be followed by a consultation with Member States and stakeholders by the Commission to discuss national measures on the matter and potential EU-harmonised incentives. Mechanisms to be considered in the green paper might include:

  1. **Setting voting rights proportional to the time of presence in a firm’s capital**, for instance by doubling voting rights for shares held longer than two years (i.e. loyalty shares on the French model), or by allowing companies to list with dual class (A and B) share structures whereby the B shares may lose their voting privileges if traded to another party (i.e. dual-class share structure on the US model).
  2. **Making returns on shares conditional upon the basis of the time the shares are held**, for instance by introducing time-weighted dividends that do not pay out in full unless the shareholder has held the shares for a pre-determined length of time (e.g. two years), or that give the right to increasing payments over time.
  3. **Decreasing capital gains tax over time** for long-term shareholders, potentially dropping tax rate to zero after a given shareholding period (e.g. after 10 years).

- **Option A2** implies that the Commission launches a **campaign to discourage listed companies to publish earnings guidance and returns on a quarterly basis** (**M2.2**). The campaign would be funded at EU level and would be aimed at companies, to raise awareness on how these market practices encourage focus on short-term financial performance at the expense of long-term investment and sustainable value creation.

### Expected advantages and disadvantages of the option

- **Advantages:** **M2.1** would help stimulate a wider public debate on long-term investment and shareholding, and support the Commission in the preliminary identification of the policy measures to be further analysed. Considering that the obligation to publish quarterly reports is no longer foreseen in the EU legislation since the 2013 Transparency Directive, **M2.2** would act at “cultural” level by raising awareness about the “side effects” of quarterly disclosure and earning guidance in terms of corporate short-termism, and possibly persuading them to abandon these market practices.

- **Disadvantages:** **M2.1** would not ensure that the public discussion is followed by substantial policy interventions to promote long-term shareholders engagement. Taken alone, **M2.2** might be too weak to counterbalance the pressure from financial markets to publish financial information on quarterly basis.

### Similar initiatives in selected third countries

| N/A |

### Option B2

#### Level of prescription

- **Non-legislative/Soft** - Foster national regulatory initiatives through recommendations

#### Key features and the functioning of the option and main stakeholders concerned

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450 ESMA (2019), cit.
Option B2 implies that the Commission prepares and publishes a recommendation for Member States to introduce mechanisms to incentivise longer shareholding periods (M2.3). The aim would be to recommend Member States to amend their national regulatory frameworks and provide for mechanisms to incentivise shareholders to have a longer term approach, in particular regarding differentiated voting rights based on the holding period of the shares. For details on possible mechanisms to be considered, see option A1. The recommendation would not have binding force and would leave up to the Member States the choice of the instruments to implement these requirements in the most suitable way according to their respective national specificities.

Similarly to option A2, also option B2 implies that the Commission launches a campaign to discourage listed companies to publish earnings guidance and returns on a quarterly basis (M2.2) (for the description of the measure, make reference to option A2 above).

**Expected advantages and disadvantages of the option**

**Advantages:** M2.3, through the instrument of the recommendation, would provide Member States with the necessary flexibility to adapt recommended modifications to their national regulatory frameworks for company law and corporate governance, avoiding a one-size-fits-all legally binding EU intervention. For expected advantages of M2.2, please make reference to option A2 above.

**Disadvantages:** For M2.3, the risk might be that Member States follow the recommendation in different ways (also considering that some of them already adopt measures to encourage long-term shareholder engagement), thus creating an even more fragmented picture at EU level. Moreover, the long-term stewardship of shareholders might not be sufficient alone to counteract the strong pressure in favour of short-termism, as there are different types of investors, with a wide variety of goals and with large portfolios that are difficult to manage in an engaged way. For expected disadvantages of M2.2, please make reference to option A2 above.

**Similar initiatives in selected third countries**

N/A

**Option C2**

**Level of prescription**

- Legislative/Hard - Set minimum common rules through EU legislative interventions

**Key features and the functioning of the option and main stakeholders concerned**

- Option C2 implies that the Commission proposes an amendment to the Shareholder Rights Directive II requiring Member States to introduce mechanisms to incentivise longer shareholding periods (M2.4). The aim of this measure would be to give longer term shareholders more control over companies in the Member States, including through mechanisms aimed at rearranging the relation between shares and voting rights. A list of possible mechanisms to be adopted by the Member States to implement this requirement would be included in the text of the Directive (for details on possible mechanisms to be considered, see option A1). The choice of the specific mechanisms to be included in the Directive would be discussed together with the relevant expert group (e.g. the technical expert group on sustainable finance; see link. Member States expert group on sustainable finance). Member States would be responsible for identifying the specific measures to implement this requirement in their respective national regulatory frameworks.

- Option C2 implies that the Commission proposes an amendment to the Transparency Directive to prohibit both earning guidance and quarterly...
Reporting for listed companies (M2.5). A new article could be added to the Directive after Article 5 on the half-yearly financial report, specifying the prohibition of reports of a shorter frequency.

### Expected advantages and disadvantages of the option

- **Advantages**: M2.4 would guarantee that all Member States have a mechanism in place to favour lengthier shareholding, allowing directors to focus more on long-term results. By prohibiting earnings guidance and disclosure of quarterly returns, M2.5 would reduce pressures coming from financial markets on directors and managers of EU listed companies in all Member States, allowing them to take a longer-term perspective.

- **Disadvantages**: M2.4 might strengthen too much the controlling position of majority shareholders at the expense of minority shareholders. Finally, both measures would require remarkable changes to the status quo, in particular for Member States with no current definition of company’s interest and no provisions concerning shareholder voting rights. There is a risk that M2.5 is not well-received by companies. The choice to publish earnings guidance and disclose returns on quarterly basis can be justified as practice improving transparency towards shareholders and the financial markets in general and strengthening executives’ accountability towards shareholders for the financial performance of the company. This measure could be regarded as adversely affecting transparency and being too intrusive of company independence.

### Similar initiatives in selected third countries

- N/A

### 8.3 Driver 3 – Companies lack a strategic perspective over sustainability and current practices fail to effectively identify and manage relevant sustainability risks and impacts

#### Option A3

**Level of prescription**

- Non-legislative/Soft - Spread corporate governance practices through awareness raising activities

**Key features and the functioning of the option and main stakeholders concerned**

- Option A3 implies that the Commission drafts a non-binding guidance document for boards to:
  - **Integrate sustainability aspects** (risks, opportunities, impacts) into the business strategy,
  - **Identify and set** as part of the business strategy measurable, specific, time-bound, and science-based sustainability targets aligned with overarching goals (such as the SDGs and the goals of the Paris Agreement), and to **disclose** appropriate information (M3.1).

- The guidance document will first clarify the importance for companies to systematically consider sustainability factors when defining their business strategy, in order to anticipate sustainability risks and address all relevant sustainability impacts connected to the company’s business model, operations and value chain, seize sustainability-related business opportunities, and integrate ESG considerations into all aspects of the company’s operations. The guidance document would also provide companies with indications on: (i) a set of general and sector-specific ESG issues to be considered in the business strategy; (ii) how to identify and set measurable, specific, time-bound, and science-based sustainability targets aligned with the SDGs or the goals of the Paris Agreement, allowing to monitor the real contribution of the company to the attainment of these goals. The identification and development of possible metrics to be adopted at company level will build on existing or forthcoming ones (e.g. in the context of the Non-Financial Directive and
related guidelines, the Taxonomy Regulation, etc.); (iii) the designation of a board member or non-executive committee in charge of monitoring sustainability factors and the implementation of the business strategy with regard to sustainability aspects, and proposing appropriate changes to the business strategy to make it more sustainable; (iv) how to disclose the sustainability elements included into the business strategy (either embedded into the “pillars” of the strategy, or conceived as a self-standing section) and report on its implementation. The guidance document would be developed by the Commission with the support of an external study or a technical expert group created ad hoc (along the model of the technical expert group on sustainable finance), and would be addressed to companies of all sizes and sectors.

The adoption of the guidance document by the Commission would be accompanied by a campaign to reach out to the business community. The campaign would encompass both dissemination activities (e.g. briefs, seminars, conferences, roundtables, etc.) and training activities for business practitioners that would be in charge of implementing the guidance document. Both dissemination and training activities would be carried out by the Commission in collaboration with relevant stakeholders (in particular business associations and NGOs), while being funded either fully at EU level or in collaboration with interested parties from the business community.

**Expected advantages and disadvantages of the option**

**Advantages:** M3.1 can be expected to raise awareness among companies of all sizes and sectors about the importance of systematically considering sustainability into the business strategy and to ease the integration of sustainability by providing a set of clear and common indications to EU companies. This measure could work as “enabler” for companies that are willing to integrate sustainability into their business strategy and to set measurable, specific, time-bound, and science-based sustainability targets, but do not take action due to limited awareness or the lack of clear indications.

**Disadvantages:** since currently there is not a common understanding of the purpose and specific content for integrating sustainability into the business strategy, the process of drafting the guidance document might be difficult, based on lengthy technical discussion among experts. Moreover, since the guidance document would lack any binding force, companies less inclined to change might still prefer to stick to the status quo, especially if they find that the document is too technical or difficult to implement.

**Similar initiatives in selected third countries**

- N/A

**Option B3**

**Level of prescription**

- Non-legislative/Soft - Foster national regulatory initiatives through recommendations

**Key features and the functioning of the option and main stakeholders concerned**

- Option B3 implies that the Commission issues a recommendation for the Member States to introduce in their respective national regulatory frameworks specific requirements for companies to integrate sustainability into their respective business strategies (M3.2). In particular, Member States would be recommended to introduce in their domestic regulatory frameworks the following:
  1. A requirement for boards to integrate sustainability aspects (risks, opportunities, impacts) into the business strategy;

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453 See [link](#).
2. A requirement for boards to **identify and set** as part of the business strategy **measurable, specific, time-bound, and science-based sustainability targets** aligned with overarching goals (such as the SDGs and the goals of the Paris Agreement), and to **disclose** appropriate information.

The recommendation would be accompanied by a non-binding **guidance document** by the Commission as described under option A3. The recommendation would not be legally binding for Member States. This measure would complement and contribute to the implementation of the duty referred to in M1.2 (EC recommendation to Member States to introduce in their respective national frameworks an explicit directors' duty to identify and mitigate sustainability risks and impacts, both internal and external, connected to the company's business operations and value chain).

### Expected advantages and disadvantages of the option

- **Advantages:** M3.2 would encourage Member States to introduce these requirements in their domestic regulatory frameworks. The recommendation would leave Member States with flexibility to consider the issues at stake and how best to implement the recommendation (including through modification of corporate governance codes) given the specificities of the national regulatory frameworks and legal traditions.

- **Disadvantages:** in terms of effectiveness, there is a risk that, in absence of a common minimum set of binding rules on the content of this exercise, the implementation of recommendation could end up in different specific requirements (e.g. in terms specific issues to be covered, targets and KPIs to be set, etc.) for companies from one Member States to the next. The persistence of heterogeneity across EU countries would remain a problem, leaving the playing field uneven.

### Similar initiatives in selected third countries

N/A

### Option C3

#### Level of prescription

- Legislative/Hard - Set minimum common rules through EU legislative interventions

#### Key features and the functioning of the option and main stakeholders concerned

- **Option C3** implies that the Commission issues a **proposal for a new EU directive requiring corporate boards to integrate sustainability aspects (risks, opportunities, impacts) into the business strategy**, to **identify and set** as part of the business strategy **measurable, specific, time-bound, and science-based sustainability targets aligned with overarching goals** (such as the SDGs and the goals of the Paris Agreement), and to **disclose** appropriate information (M3.3). The new directive would introduce a legally-binding obligation for directors to consider sustainability factors when defining the business strategy on behalf of the company, identifying and addressing sustainability risks and opportunities as well as all relevant sustainability impacts connected to the company's business model, operations and value chain (upstream and downstream). The new directive would also require directors to identify and set as part of the business strategy measurable, specific, time-bound, and science-based sustainability targets aligned with overarching sustainability objectives (such as the SDGs or the goals of the Paris Agreement), and make them responsible for monitoring the targets and reviewing the business strategy accordingly.

The directive would be accompanied by the non-binding **guidance document** prepared by the Commission described under option A3 and would also lay down the legal basis for the adoption of binding Commission guidelines. However, the directive would leave companies free to decide on how to implement these requirements in practice. There is room to exploit synergies between this option and the review of the Non-Financial Reporting Directive, to maximise the effectiveness and impact of both measures. Ideally, sustainability targets identified by the companies should be aligned with key sustainability KPIs disclosed by them.
as part of their non-financial disclosure pursuant to the Non-Financial Reporting Directive. The requirements of the directive would cover large companies (e.g. the scope of application would be aligned with the one of the Non-Financial Reporting Directive). However, the directive would also recommend Member States to extend its application to SMEs that operate in high-risk sectors.\footnote{Based on their social and environmental impacts, sectors that could to be considered include garment, oil and gas, chemical, and construction sectors.}

This measure would complement and contribute to the implementation of the duty referred to in M1.3 (new EU directive requiring directors to identify and mitigate sustainability risks and impacts, both internal and external, connected to the company’s business operations and value chain).

**Expected advantages and disadvantages of the option**

- **Advantages**: \textbf{M3.3} would ensure that equal requirements apply to all large companies, thus contributing to a more level playing field. The inclusion of measurable, specific, time-bound, and science-based targets would also ensure that companies set sustainability targets that are in line with broader goals, such as the SDGs. The inclusion of such targets also enable a better monitoring of the contribution of companies towards these objectives and of the overall progress of society towards their attainment, contributing to a stronger and more complete evidence base for national and EU policy makers.

- **Disadvantages**: the absence of obligations concerning the integration of sustainability in the business strategy in the legal frameworks of most Member States indicates that this is largely an unregulated practice which will probably require extensive discussions between the Commission, the Member States and other concerned stakeholders (namely business associations). Moreover, option C3 can also be expected to lead to an increase of compliance costs for companies that currently do not have integrated sustainability into their business strategy and have not set measurable, specific, time-bound, and science-based sustainability targets.

**Similar initiatives in selected third countries**

N/A

### 8.4 Driver 4 – Board remuneration structures incentivise the focus on short-term shareholder value rather than long-term value creation for the company

**Option A4**

**Level of prescription**

- Non-legislative/Soft - Spread corporate governance practices through awareness raising activities

**Key features and the functioning of the option and main stakeholders concerned**

- Option A4 implies that the Commission launches a \textit{campaign to encourage companies to link board remuneration to long-term, sustainable value creation for the company} (\textbf{M4.1}). The campaign would be funded at EU level and would be aimed in particular at companies, providing them suggestions and best practices on remuneration policies creating long-term incentives. The list of best practices would be developed by the Commission with the support of a targeted consultation, similar to the one performed for the guidelines on the standardised presentation of the remuneration policy.\footnote{See \url{link}.} This campaign would be in line with recent policy developments, such as the Shareholder Rights Directive II, where article 9a says that companies’ remuneration policy shall contribute to the company’s business strategy and long-term interests and sustainability, including, where appropriate, performance criteria relating to CSR.
### Expected advantages and disadvantages of the option

- **Advantages:** M4.1 would complement existing legislation and self-regulatory provisions by increasing awareness in the business community on the importance of linking board remuneration to ESG metrics as a way to create incentives for directors to consider sustainability risks and impacts more closely and focus on long-term sustainable value creation.
- **Disadvantages:** M4.1 might be too weak to counterbalance the pressure to include short-term financial targets in companies’ remuneration policies, as this is considered an important incentive to align directors’ interest to the interest of shareholders (including investors with a short-term focus).

### Similar initiatives in selected third countries

N/A

### Option B4

**Level of prescription**

- Non-legislative/Soft - Foster national regulatory initiatives through recommendations

### Key features and the functioning of the option and main stakeholders concerned

- Option B4 implies that the Commission prepares and publishes a recommendation for Member States on the remuneration policies of companies (M4.2). The recommendation would provide a list of possible measures to be introduced in the national regulatory frameworks, to change the nature of incentives for directors from the short to the long-term, including:
  1. A provision to restrict executives’ ability to sell shares they receive as pay (e.g. requiring shares be held at least five years after they were granted, and at least three years after a buyback; requiring executives to hold shares in a company for a given period after the termination of their employment with the company);
  2. A provision to make compulsory the inclusion of non-financial, ESG metrics, linked to a company’s sustainability targets, in executive pay scheme.
- The recommendation would not be legally binding for Member States and would leave them flexibility as to the way to implement these provisions domestically.

### Expected advantages and disadvantages of the option

- **Advantages:** M4.2 would encourage Member States to introduce these provisions in their national regulatory frameworks, leaving them the necessary flexibility to consider the issue at stake and how best implement the recommendation given the specificities of the national regulatory frameworks and legal traditions.
- **Disadvantages:** The introduction of different specific requirements at national level might end up further complicating the regulatory picture across Member States, with possible adverse consequences for internal competition (as companies might be subject to more stringent rules concerning board remuneration in certain EU countries than in other).

### Similar initiatives in selected third countries

N/A

### Option C4

**Level of prescription**

- Legislative/Hard - Set minimum common rules through EU legislative interventions

### Key features and the functioning of the option and main stakeholders concerned

- Option C4 implies that the Commission proposes an amendment to the Shareholder Rights Directive II to align executive remuneration policy with the long-term and sustainability goals (M4.3). More specifically, the
amendment could modify Article 9a of the Directive about the remuneration policy of companies to:

1. Introduce restrictions on executives’ ability to sell the shares they receive as pay (e.g. requiring shares be held at least five years after they were granted, and at least three years after a buyback; requiring executives to hold shares in a company for a given period after the termination of their employment with the company);

2. Make compulsory the inclusion of non-financial, ESG metrics, linked to a company’s sustainability targets, in the performance criteria for variable remuneration.

- The aim of this amendment would be to weaken the financial incentive to focus exclusively on shareholder returns and ensure that directors are focused on the long-term interests of all corporate stakeholders. These amendments would be defined by the Commission with the support of relevant expert groups (e.g. the expert group on company law;456 Member States expert group on sustainable finance457; technical expert group on sustainable finance458), and after consulting relevant stakeholders, in particular companies. This scope of application of this measure would be the same of the Shareholder Rights Directive II (companies that have their registered office in the EU and their shares listed on an EU regulated market).

**Expected advantages and disadvantages of the option**

- **Advantages:** M4.3 would introduce harmonised requirements for the remuneration policy of listed companies across Member States and financial incentives for directors to focus on the long term and the achievement of sustainability goals.

- **Disadvantages:** by introducing specific requirements on the remuneration policy, M4.3 might be considered too “rigid” (i.e. limiting remuneration committees’ ability to set up an executive remuneration scheme that suits best the corporate business strategy) and intrusive of company independence.

**Similar initiatives in selected third countries**

N/A

8.5 **Driver 5 – The current board composition does not fully support a shift towards sustainability**

**Option A5**

**Level of prescription**

- Non-legislative/Soft - Spread corporate governance practices through awareness raising activities

**Key features and the functioning of the option and main stakeholders concerned**

- Option A5 implies that the Commission launches an **awareness-raising campaign (M5.1)**, addressed primarily to the European business community, with the objective of encouraging companies **to include sustainability expertise at board level**. Specifically, the campaign would be aimed at promoting the consideration of sustainability-related competence and expertise in the board nomination process (e.g. expertise on sustainability related issues relevant to the company’s business model, on sustainability risk assessment, on non-financial reporting) and the appointment of new board roles (such the chief value officer) to ensure that all relevant aspects of value creation and destruction are accounted for and communicated to boards, management, and external stakeholders. The campaign would be designed by the Commission in collaboration with interested

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456 See link.
457 See link.
458 See link.
stakeholders (e.g. NGOs; national public authorities; national and EU business associations, and companies), which could play a role as partners in organising the campaign-related events and involving relevant audience. The campaign would be funded at EU level and would be implemented through various channels (e.g. conferences, roundtables, stakeholder meetings, etc.), as to ensure an extensive geographical coverage of EU territory.

**Expected advantages and disadvantages of the option**

- **Advantages**: M5.1 would help raising awareness among companies on the importance of sustainability expertise at board level, to guarantee that the right competences are involved in companies’ decision-making and better tackling sustainability issues.
- **Disadvantages**: this measure might be too weak to bring a real change on the ground. In particular, companies might prefer to stick to the status quo until the adoption of binding legislation.

**Similar initiatives in selected third countries**

N/A

**Option B5**

**Level of prescription**

- Non-legislative/Soft - Foster national regulatory initiatives through recommendations

**Key features and the functioning of the option and main stakeholders concerned**

- Option B5 implies that the Commission issues a recommendation for the Member States to introduce provisions aimed at requiring listed companies to systematically consider sustainability-related competence and expertise in the board nomination process (M5.2). The recommendation would thus encourage Member States to introduce measures at national level to require listed companies to systematically consider sustainability as a criteria in their board nomination process (possibly on a “comply or explain” basis). The recommendation would not be legally binding for Member States.

**Expected advantages and disadvantages of the option**

- **Advantages**: this measure would encourage Member States to address the issue of expertise in board composition from both a sustainability and gender perspective, while leaving to the Member States the flexibility to intervene in the way they deem most effective given their respective national situations.
- **Disadvantages**: option B6 might not be conducive to a more level playing field for listed companies across EU Member States. Some Member States might decide not to follow Commission recommendation and stick with the situation as is.

**Similar initiatives in selected third countries**

N/A

**Option C5**

**Level of prescription**

- Legislative/Hard - Set minimum common rules through EU legislative interventions

**Key features and the functioning of the option and main stakeholders concerned**

- Option C5 implies that the Commission issues a proposal for a new EU directive laying down rules on board composition of listed companies (M5.3), in view of promoting greater attention towards sustainability in corporate boards. The directive would include an obligation to consider sustainability criteria in the board nomination process. The directive would thus require Member States to include in their respective national frameworks an obligation for listed companies to consider sustainability-related expertise and competence (e.g. expertise on sustainability
related issues relevant to the company’s business model, on sustainability risk assessment, on non-financial reporting, etc.) as a selection criteria in the board nomination process. This new directive would ensure that in the board nomination process, competence in relevant sustainability matters is systematically considered.

**Expected advantages and disadvantages of the option**

- **Advantages:** The **M5.3** would promote expertise in the boardroom of European listed companies by setting common rules. This measure would contribute to leading EU companies towards an increased sustainability and to a more level playing field at EU level.
- **Disadvantages:** A proposal introducing stringent requirements on board composition could meet the resistance of the business community, as it would likely be perceived as too intrusive of companies’ independence to decide in their own best interest. Companies would be in favour of keeping the status quo and continue relying on voluntary initiatives based on corporate governance codes (where specific requirements on board composition are not already mandated by law). Moreover, it might be difficult to achieve the level of political support which is necessary to put forward the proposal.

**Similar initiatives in selected third countries**

- N/A

### 8.6 Driver 6 – Current corporate governance frameworks and practices do not sufficiently voice the long-term interests of stakeholders

**Option A6**

**Level of prescription**

- Non-legislative/Soft - Spread corporate governance practices through awareness raising activities

**Key features and the functioning of the option and main stakeholders concerned**

- Option A7 implies that the Commission establishes an **Advisory Group on Sustainable Corporate Governance (M6.1)** involving representatives from associations representing a broad range of stakeholders interested in corporate governance topics (e.g. directors, shareholders, investors, workers, civil society organisations and NGOs, etc.), either as full members or observers. The Advisory Group would provide the Commission with stakeholders’ views on measures to promote more sustainable corporate governance, in particular by discussing good practices on effective stakeholder engagement and involvement by companies, including at board level. The Advisory Group would meet regularly for plenary sessions, and would include also sub-groups and ad-hoc working groups to address specific and more technical issues. Best practices on stakeholder engagement and involvement identified by the Advisory Group could eventually be disseminated through a dedicated campaign carried out by the Commission.

**Expected advantages and disadvantages of the option**

- **Advantages:** M6.1 would allow the Commission to create a platform for discussing with stakeholders interested in corporate governance topics on a regular basis. This would help the Commission in identifying best practices and understanding what issues are high on the agenda of the different stakeholder constituencies represented in the group. This measure would promote larger and more effective involvement of stakeholders by the companies through the dissemination of the best practices on stakeholder engagement identified by the Advisory Group.
- **Disadvantages:** Given the large number of stakeholders potentially interested in corporate governance or impacted by business activities, it might be difficult to include all relevant stakeholders in the group. Moreover, certain stakeholders categories might be better organised and represented than others, so it might be difficult to strike the right balance among stakeholder to avoid that some of them “capture” consultation process.
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## Similar initiatives in selected third countries

<table>
<thead>
<tr>
<th>Option</th>
<th>Level of prescription</th>
<th>Key features and the functioning of the option and main stakeholders concerned</th>
<th>Expected advantages and disadvantages of the option</th>
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<tbody>
<tr>
<td>B7</td>
<td>Non-legislative/Soft</td>
<td>- Foster national regulatory initiatives through recommendations</td>
<td></td>
<td>N/A</td>
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<td></td>
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<td>• Option B6 implies that the Commission issues a <strong>recommendation for the Member States to introduce in their respective national frameworks a requirement for companies to actively engage with and involve both internal and external stakeholders</strong> at board level, in particular in the process of identifying, preventing and mitigating sustainability risks and impacts as part of their business strategy (<strong>M6.2</strong>). The recommendation would encourage Member States to introduce a national obligation for companies to ensure that both internal (e.g. employees, shareholders) and external stakeholders (e.g. creditors, customers, suppliers, local communities, NGOs, etc.) are involved in the process of identifying, preventing and mitigating the company’s sustainability risk and impacts from an environmental, social and economic perspective. Stakeholders would be enabled to provide their contribution on aspects such as risk mapping, risk assessment, risk migration, materiality analysis, and target-setting, thus supporting boards in integrating sustainability considerations into the business strategy. Stakeholders would also be allowed to monitor on the effectiveness of the measures taken by the companies to address sustainability aspects associated with the company’s business model, operations and value chain. This measure could be implemented in synergy with M3.2 (recommendation for the Member States to introduce in their respective national frameworks specific requirements for boards to consider, disclose and integrate sustainability aspects (risks, opportunities, impacts) into the business strategy) as well as with M1.2 (EC recommendation providing a uniform interpretation of directors’ duties and company’s interest to the Member States and recommending them to introduce in their respective national frameworks an explicit directors' duty to identify and mitigate sustainability risks and impacts, both internal and external, connected to the company’s business operations and value chain). The recommendation would not be legally binding for Member States.</td>
<td>• <strong>Advantages:</strong> <strong>M6.2</strong> would allow Member States flexibility for implementing the recommendation in the way they deem most suitable (e.g. either through a legislative change or a modification of the national corporate governance code), based on the specificities of their national regulatory framework. It also would leave to the Member States the definition of specific stakeholder categories to be necessarily involved by companies as well as the indication of specific mechanisms for stakeholder involvement. • <strong>Disadvantages:</strong> due to recommendation’s lack of legal force, there is the risk that Member States do not conform to it or conform to it differently, increasing the heterogeneity of national regulatory frameworks. In fact, different stakeholder categories might end up being involved to different extent and through different mechanisms in different Member States.</td>
<td>N/A</td>
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<tr>
<td>C6</td>
<td>Legislative/Hard</td>
<td>- Set minimum common rules through EU legislative interventions</td>
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Option C6 implies that the Commission issues a proposal for **new EU binding rules requiring corporate boards to establish mechanisms for engaging with and involving both internal and external stakeholders** at board level, in particular in the process of identifying, preventing and mitigating sustainability risks and impacts as part of their business strategy (M6.3). This legislative intervention would lay down an obligation for the boards of directors to set up and disclose specific stakeholder engagement mechanisms (e.g. annual stakeholder meetings, stakeholder advisory councils, non-executive board seat assigned to workers, etc.) to involve company stakeholders’ in decision-making processes, in particular as concerns the definition of a comprehensive business strategy addressing the sustainability risks and impacts stemming from the business activities. Stakeholder engagement should be undertaken based on a stakeholder mapping exercise, including throughout the company value chain, supervised and validated by the board. Internal and external stakeholders would be enabled to express their views to the boards on sustainability-related aspects (such as risk mapping, risk assessment, risk mitigation, materiality analysis, sustainability targets, etc.) and contribute to defining and supervising the effective integration of sustainability into the companies’ business strategies. This measure could be implemented in synergy with M3.3 (proposal for a new EU directive requiring corporate boards to integrate sustainability aspects (risks, opportunities, impacts) into the business strategy) as well as with M1.3 (regarding an EU directive providing an EU-wide formulation of directors’ duties and company’s interest, including a duty of board members to identify risks and mitigate negative human and environmental impact in the value chain). These new EU binding rules would cover large companies (e.g. the scope of application would be aligned with the one of the Non-Financial Reporting Directive). However, the directive would also recommend Member States to extend its application to SMEs that operate in high-risk sectors.

**Expected advantages and disadvantages of the option**

- **Advantages**: M6.3 would promote stakeholder engagement with the board of large EU companies by introducing a common obligation. At the same time, it would leave companies with enough flexibility to identify and implement the stakeholder engagement mechanisms that they deem more suitable.
- **Disadvantages**: while introducing an obligation to set mechanisms for stakeholder engagement, the legislative intervention will not define the stakeholder constituencies that should be engaged by companies. This leaves room for companies to focus on certain stakeholder categories, and leaves open the risk of “stakeholder primacy” with the over-representation of the constituencies that are better organised and have more resources to engage in the board decision making processes.

**Similar initiatives in selected third countries**

- N/A

**8.7 Driver 7 – Enforcement of directors’ duty to act in the long-term interest of company is limited**

**Option B7**

**Level of prescription**

- Non-legislative/Soft recommendations - Foster national regulatory initiatives through recommendations

**Key features and the functioning of the option and main stakeholders concerned**

- Option B7 implies that the Commission issues a **recommendation for the Member States to consider measures to strengthen the enforcement of**

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459 Based on their social and environmental impacts, sectors that could to be considered include garment, oil and gas, chemical, and construction sectors.
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**Directors’ duty to act in the interest of the company** in their respective national frameworks (*M7.1*). In particular, the recommendation would encourage Member States to consider judicial mechanisms to enable also stakeholders (other than shareholders) to enforce directors’ duty to act in the interest of the company, which involve the identification and mitigation of sustainability risks and impacts associated with company’s business model, operations and value chain. The recommendation could call Member States to consider whether, in their national legal system, stakeholders (other than shareholders) with a legitimate interest in the corporation’s future sustainability (e.g. that company’s survival affects the economic security of a community) could be allowed to launch some legal action on behalf of the company against board members (so-called derivative action) in case a company failed to consider sustainability risks (e.g. climate change risks).

Along the same vein, the recommendation could invite Member States to make available to stakeholders adversely affected by the directors’ failure to identify sustainability risks and impacts judicial mechanisms such as formal notice to comply, injunctions to pay a fine, legal action in case of failure to comply with the directors’ duty or mis-execution of measures aimed at addressing stakeholders’ interests. The recommendation should be drafted with the support of a technical expert group composed of legal experts from the Member States.

This measure would provide for a proper enforcement mechanism for: *M1.2* (EC recommendation providing a uniform interpretation of directors’ duties and company’s interest to the Member States and recommending them to introduce in their respective national frameworks an explicit directors’ duty to identify and mitigate sustainability risks and impacts, both internal and external, connected to the company’s business operations and value chain) and *M3.2* (EC recommendation for the Member States to introduce in their respective national frameworks specific requirements for boards to integrate sustainability aspects (risks, opportunities, impacts) into the business strategy), and could therefore be implemented in synergy with them. The recommendation would not be legally binding for Member States.

**Expected advantages and disadvantages of the option**

- **Advantages:** *M7.1* would raise awareness among Member States on the problem of the low level of enforcement of directors’ duties and could help the Commission have a deeper understanding of the legal possibilities for enforcement that are currently available in the Member States.
- **Disadvantages:** given the non-binding nature of the instrument, the technicality of the matter, and the strength of the shareholder primacy norm, there is a serious risk that Member States would prefer sticking to the status quo rather than consider a policy intervention to amend their respective national regulatory frameworks. Therefore, the recommendation might not be sufficient to bring about the adoption of the national measures necessary to strengthen the enforcement of directors’ duties.

**Similar initiatives in selected third countries**

- N/A

**Option C7**

**Level of prescription**

- Legislative/Hard - Set minimum common rules through EU legislative interventions

**Key features and the functioning of the option and main stakeholders concerned**

- Option C8 implies that the Commission issues a proposal for new EU binding rules to strengthen the enforcement of the directors’ duty to act in the interest of the company (*M7.2*). Taking the form of a Directive, this legislative intervention would require Member States to ensure that judicial mechanisms are in place for stakeholders that are adversely affected by the directors’ failure to take their interests into account in their decisions, to identify and mitigate the sustainability risks and impacts, or by the mis-execution of measures aimed at
addressing stakeholders’ interests. Judicial mechanisms available to stakeholders could include a formal notice to comply, injunctions to pay a fine, and legal action in case of failure to comply with the directors’ duty. This measure would also require Member States to empower a national regulatory body to bring proceedings against the directors where the failure to identify and mitigate sustainability impacts and risks, or the mis-execution of measures aimed at addressing stakeholders’ interests caused serious harm to third parties or unlawful harm to the environment, stakeholders or the company itself.

This measure would provide for a proper enforcement mechanism for M1.3 (regarding an EU directive providing an EU-wide formulation of directors’ duties and company’s interest, including a duty of board members to identify risks and mitigate negative human and environmental impact in the value chain) and for M3.3 (EC proposal for a new EU directive requiring corporate boards to consider and integrate sustainability aspects (risks, opportunities, impacts) into the business strategy) and could therefore be implemented in synergy with them.

Expected advantages and disadvantages of the option

- **Advantages**: M7.2 would strengthen directors’ accountability for their duty to act in the interest of the company and mitigate sustainability risks and impacts by ensuring that across EU jurisdiction certain judicial mechanisms are available to stakeholder categories with a legitimate interest in the company’s sustainability (including local communities, employees, consumers, trade unions, associations or NGO).

- **Disadvantages**: the enforcement of directors’ duties is a legal aspect specific to the different EU jurisdictions and not regulated at EU level. The implementation of this measure might be difficult as it would require lengthy discussion about specific technical aspects such as: how directors’ duty to act in the interest of the company should be interpreted; specific judicial mechanisms that Member States could put in place to make enforcement more effective; specific criteria that have to be met to grant access to these judicial mechanisms to the stakeholders. It would also generate costs linked to the creation of a body (or the enlargement of competences of an existing body) to bring proceedings against the directors.

Similar initiatives in selected third countries

- In Australia, the Australian Securities and Investments Commission has power to bring proceedings in the public interest against directors for breach of duty.
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