European Commission
DG Justice and Consumers

Re: Inception impact assessment relating to sustainable corporate governance

The Finnish Securities Market Association (SMA) would like to thank the European Commission for the opportunity to comment the inception impact assessment (IIA) relating to sustainable corporate governance.

The SMA is an association promoting efficient self-regulation and good securities market practice. The association is responsible for the maintenance of the Finnish Corporate Governance Code and Helsinki Takeover Code. The association also provides guidance on the practical application of the two Codes. The founding members of the association are the Confederation of Finnish Industries EK, Finland Chamber of Commerce and Nasdaq Helsinki Ltd. All Finnish companies listed in the Helsinki Stock Exchange are supporting members of the association.

Executive summary

To summarise our position, we:

- Fully support the objective to embed sustainability into companies' decision-making. Directors acting in the interest of the company are already doing so;
- Consider that certain policy options presented in the IIA would be detrimental to the competitiveness of European companies and make European companies less attractive as investment targets. This is the case for proposals affecting the core of company law, such as the directors' obligation to take into account all stakeholders' interests and related enforcement mechanisms, such as directors' liability. Such an obligation would distort the clarity of the chain of accountability;
- Prefer soft-law measures instead of EU legislation;
- Remind that any policy proposal should respect the principle of proportionality and should not create unlevel playing field between listed and non-listed companies.

General remarks

The SMA fully supports the objective to embed sustainability into companies' decision-making. Indeed, studies have shown that in the long term sustainable companies perform better and create more value for shareholders. Directors acting in the interest of the company are therefore taking stakeholders' interests into account and this is also in the interest of the shareholders. In addition, investors, customers and other stakeholders also encourage companies to act in a sustainable manner.

To a certain extent, EU action is in our view necessary to promote single market and to achieve level playing field both within the EU and internationally. For example, with regard to due diligence obligations in the value chain, EU should strive for as global solution as possible to avoid a patchwork of national laws with differing requirements.

However, certain policy options presented in the IIA would be detrimental to the competitiveness of European companies. This is the case for proposals relating to company law, such as the directors' obligation to take into account all stakeholders' interests and related enforcement mechanisms, such as directors' liability.

Moreover, we note that any policy proposal should respect the principle of proportionality and should not create unlevel playing field between listed and non-listed companies.

Directors' duties and accountability should not be blurred

In order to promote shareholder value (the so-called shareholder primacy norm) the directors are required to act in the best interest of the company. In carrying out this duty they are accountable to shareholders of the company. We would like to highlight that the shareholder primacy norm is not in any way in contradiction with the objective to promote sustainability. As mentioned, companies acting in sustainable manner often perform better in the long term than their less sustainable peers. It is thus in the interest of shareholders that directors of a company take stakeholders' interests into account in their decision-making.

However, an explicit requirement for directors to take stakeholders' interests into account, as suggested in the IIA, would distort the clarity of the chain of accountability. Directors' liability towards shareholders would be reduced, which would make the alignment of directors' interests with the interests of the company more difficult and thus affect negatively to the value creation of the company.

Moreover, the interests of various stakeholders are not always aligned. It would be practically impossible to prescribe at the level of company law how directors should balance such diverging interests.

Allegations on short-terminism are exaggerated

We have understood that the policy options relating to directors' duties are mainly based on the recently published study on directors' duties and sustainable corporate governance. The policy options presented in the study are based on the hypothesis of the existence of undue short-terminism in corporate decision-making. In our view, one cannot conclude from a mere comparison of shareholder payouts and investments in capital expenditure and R&D that undue short-terminism exists.

The study seems to ignore the fact that the basic function of the capital markets is to allocate risk capital. The risk capital allocation process enables also funding to investments in sustainable products and processes and sustainable growth. Payouts to shareholders are an indication that the markets are functioning properly. A significant proportion of the payouts to shareholders is reinvested to capital markets.

Moreover, the study focuses on data relating to listed companies and completely omits the role of unlisted growth companies. During the past three decades the role of venture capital has increased. Increasing proportion of R&D investments are concentrating to unlisted growth companies funded by VC investors and public listing takes place at a more mature stage of the company life cycle.

We also note that shareholding structures and corporate governance regimes across the EU vary significantly. For example, the Nordic corporate governance model is characterised by strong shareholder rights and active governance role of major shareholders. There are studies suggesting that this kind of governance model reduces the risk of undue short-terminism. This also speaks for soft-law measures rather than EU legislation, as negative effects on well-functioning national corporate governance frameworks would be less severe.

Finally, we would like to highlight that the reports of ESMA, EBA and EIOPA published in December 2019 on undue short-terminism in the securities, banking and insurance sectors respectively did not highlight any major corporate governance related issues which would merit rewriting of rules relating to directors' duties and liability.

Alignment with the objectives of the Capital Markets Union needed

The recent amendments to the Shareholders' Rights Directive have already encouraged long-term engagement of shareholders and strengthened the link between the directors' remuneration and long-term interests and sustainability of the company. In addition, there are several initiatives in the pipeline which will encourage companies to act sustainably. First, sustainable finance taxonomy harmonises the concept of sustainable business. Second, the sustainable finance disclosure regulation enhances transparency of how financial market participants and financial advisers integrate sustainability risks in their processes. Third, the ongoing review of non-financial reporting directive will most likely lead to more harmonised sustainability reporting. Finally, the renewed sustainable finance strategy will likely increase capital flows to sustainable investments.

Even more importantly, the change is happening even without pressure from legislation. Investors – both private and institutional – customers and other stakeholders are pushing companies towards sustainable business models. Legislative changes affecting the core of company law are therefore not required.

In our view, the amendments suggested in the IIA relating directors' duties would also undermine the objectives of the Capital Markets Union. Europe needs more integrated and better functioning capital markets. The objectives of the Green Deal and the EU climate target require investments that cannot be funded without well-functioning capital markets.

The policy options suggested in the IIA would make the European companies less attractive as investment targets. The cost of capital would increase and the availability of risk capital decrease. Moreover, any legislation aimed at listed companies only would increase the barriers for listing, which would also be against the CMU objectives.

Yours sincerely,

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