

COMMENT LETTER

February 8, 2021

EU ESG: Final Response to Commission Consultation on Sustainable Corporate Governance Legislation (pdf)

8 February 2021 ICI Global Response to European Commission's Consultation on Upcoming Sustainable Corporate Governance Legislation¹ [Our responses to Q14 and Q21 are highlighted below in yellow.] Section III: Due diligence duty For the purposes of this consultation, "due diligence duty" refers to a legal requirement for companies to establish and implement adequate processes with a view to prevent, mitigate and account for human rights (including labour rights and working conditions), health and environmental impacts, including relating to climate change, both in the company's own operations and in the company's supply chain. "Supply chain" is understood within the broad definition of a company's "business relationships" and includes subsidiaries as well as suppliers and subcontractors. The company is expected to make reasonable efforts, for example, with respect to identifying suppliers and subcontractors. Furthermore, due diligence is inherently risk-based, proportionate and context specific. This implies that the extent of implementing actions should depend on the risks of adverse impacts the company is possibly causing, contributing to or should foresee. Question 14. Please explain whether you agree with this definition and provide reasons for your answer. [Includes a box for explanation.] ICI Response: Our comments relate to how any new legislative requirements would apply to fund managers. The Sustainable Finance Disclosure Regulation (SFDR) and forthcoming amendments to Delegated Acts under the UCITS Directive and AIFMD will impose significant new due diligence requirements on fund managers with respect to adverse sustainability impacts of investment decisions. These due diligence requirements have a basis in the OECD guidelines on 'Responsible business conduct for institutional investors: Key considerations for due diligence'² under the OECD Guidelines for Multinational Enterprises, which the Commission references as a potential basis for a corporate due diligence duty. It is essential that any new legislative requirements for supply chain due diligence do not duplicate or conflict with the due diligence provisions in SFDR and any forthcoming amendments to Delegated Acts under the UCITS Directive and AIFMD. We caution that the application of additional due diligence requirements not tailored for fund management could severely disrupt the investment process, harming investors saving for retirement, education, and other important financial goals. 1 The consultation is available at <https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12548-Sustainable-corporate-governance/public-consultation>. 2 See Recital 18, Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector, available at <https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32019R2088&from=EN#d1e40-1-1>, referencing OECD

(2017), Responsible business conduct for institutional investors: Key considerations for due diligence under the OECD Guidelines for Multinational Enterprises, available at <https://mneguidelines.oecd.org/RBC-for-Institutional-Investors.pdf>. 8 February 2021 Section IV: Other elements of sustainable corporate governance Question 21: Remuneration of directors. Current executive remuneration schemes, in particular share-based remuneration and variable performance criteria, promote focus on short-term financial value maximisation (Study on directors' duties and sustainable corporate governance). Please rank the following options in terms of their effectiveness to contribute to countering remuneration incentivising short-term focus in your view. This question is being asked in addition to questions 40 and 41 of the Consultation on the Renewed Sustainable Finance Strategy the answers to which the Commission is currently analyzing. (Ranking 1-7 (1: least efficient, 7: most efficient)).

- ☐ Restricting executive directors' ability to sell the shares they receive as pay for a certain period (e.g. requiring shares to be held for a certain period after they were granted, after a share buy-back by the company).
- ☐ Regulating the maximum percentage of share-based remuneration in the total remuneration of directors.
- ☐ Regulating or limiting possible types of variable remuneration of directors (e.g., only shares but not share options).
- ☐ Making compulsory the inclusion of sustainability metrics linked, for example, to the company's sustainability targets or performance in the variable remuneration.
- ☐ Mandatory proportion of variable remuneration linked to non-financial performance criteria.
- ☐ Requirement to include carbon emission reductions, where applicable, in the lists of sustainability factors affecting directors' variable remuneration.
- ☐ Taking into account workforce remuneration and related policies when setting director remuneration.
- ☐ Other option, please specify.
- ☐ None of these options should be pursued, please explain. [Includes a box for explanation.]

ICI Response: Our comments relate to how any new legislative requirements would apply to fund managers. We note that fund managers are already subject to extensive remuneration requirements under the UCITS Directive and AIFMD, as applicable, as well as the MiFID/IFR remuneration requirements applicable to investment firms. These rules are carefully tailored for the fund management context and are designed to disincentivize short-termism and instead align the interests of fund managers with the long-term interests of fund investors and the fund management company. ESMA recognized this in its advice to the Commission on whether and how the financial sector places undue short-termism pressure on corporations, including advice on areas that regulators should address.³ Notably, ESMA did not recommend immediate legislative action on fund manager remuneration. Instead, ESMA recommended that the Commission first monitor the impact of the new SFDR requirements for UCITS management companies and AIFMs before assessing a potential need for further regulatory requirements. These new SFDR provisions will require fund managers to disclose how their remuneration policies are consistent with the integration of sustainability risks. ³ See ESMA Report: Undue short-term pressure on corporations (18 December 2019), available at https://www.esma.europa.eu/sites/default/files/library/esma30-22-762_report_on_undue_short-term_pressure_on_corporations_from_the_financial_sector.pdf. 8 February 2021 We therefore urge the Commission to ensure that any new remuneration requirements in this sustainable corporate governance initiative do not duplicate or conflict with the existing requirements to which fund managers are subject.