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The European Commission
Directorate-General for Justice and Consumers
Unit for Company Law
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Joint response to the European Commission's roadmap on sustainable corporate governance

With reference to the possibility to submit feedback in relation to the European Commission's initiative Sustainable Corporate Governance and the related EY study on directors' duties (the "**Report**"), the undersigned German, Danish and Swedish self-regulatory bodies, business associations and institutional investors (the "**Respondents**") would like to submit the following joint statement.

The Respondents would first like to emphasize that they share the Commission's underlying objectives. Fighting climate change and promoting human rights must certainly be priorities for the European Union and each of its Member States. However, the current path of development where the proposed solutions to these important matters are sought within company law and corporate governance is deeply worrying. The "solutions" presented in the Report are likely to be detrimental to the structural transformation necessary to reach the desired objectives. If the proposals were to become a reality, there would be a substantial risk that European companies would get less access to risk capital, implying that business sector dynamism and innovation will be hampered, and that the incentives for undertaking forward-looking investments and innovations necessary to support sustainable economic growth will be undermined.

The Report proposes a number of changes to the company law principles and corporate governance models of the Member States pertaining to the composition and duties of boards of directors of limited liability companies with a view to reducing what is referred to as short termism in corporate governance and contributing to a sustainable development. The Report defines "short termism" as the ratio between, on one hand, a company's pay-outs in terms of dividends and share buybacks and, on the other hand, the company's net income. The higher the ratio, the greater the short termism since the distributed funds, according to the Report, should instead have been reinvested in the company. The Report is wholly devoid of reasoning on the critical interaction between the supply of risk capital and the dynamics of the business sector or, expressed another way, the role played by the capital market in allocating and re-allocating resources. Dynamism and innovation in businesses require the

avoidance of lock-in effects. The prospects of competitive yields are fundamental to the ability of companies to attract risk capital from what today is a global capital market. In addition, funds must be re-allocated from companies that lack profitable investment alternatives to forward-looking companies with profitable projects. This is a profoundly central function in a dynamic economy and has long been a cornerstone of economic policy which is aiming to promote a continuous process of structural change. Taking Sweden as an example, it is not difficult to imagine what Swedish business would look like today if company profits were largely required to remain in the shipbuilding industry, the textile industry, and other industries that were the flagships not too many decades ago.

The Report appears to build on the assumption that distributed funds “disappear” in private consumption or similar. Naturally, this is not the case. Institutional owners such as pension funds, insurance companies, mutual funds, long-term active asset-managers and similar institutions are responsible for approximately 90% of ownership on the Stockholm Stock Exchange. The situation is roughly the same in many Member States. The funds paid out to these investors, as well as to other categories of large owners such as foundations, are essentially re-deployed in new investments in listed companies, other areas of the business community or passed on to cutting edge research through large foundations.

As regards the link between pay-outs, the composition of the board of directors and their mandate on the one hand, and the sustainability goals on the other, the Report demonstrates no causal relationship. This is serious indeed, particularly in light of the fact that it is the dynamism and the re-inventiveness of the business sector which will be critical to our ability to solve the challenges of the future, including climate change. A process in which companies, within the applicable legal and regulatory restrictions, continuously strive to identify profitable investments and a redistribution from stagnating industries to future businesses. Anecdotally, it may be noted that the European Central Bank, ECB, recently published a report which shows that companies in countries with highly efficient stock markets (all things being equal) demonstrate a lower carbon footprint than countries with less developed stock markets. One reason among others is that better access to risk capital leads to more research and development, a greater number of environmental patents and makes room for greater risk-taking in forward-looking industries with less impact on the climate.

The empirical component of the Report is based on a review of the situation in 16 European countries (including the UK) pertaining to approximately 4,500 listed companies. An initial reflection on the population of listed companies is that a significant portion and perhaps as much as one-third of these companies are UK listed companies. Naturally, already this fact alone is unacceptable in a study which is intended to form the basis of reforms exclusively in countries other than UK. This is particularly grave given the fact that UK companies appear to diverge from the average in those respects studied by the report. Moreover, the logic of using dividend levels in countries such as Slovakia and Slovenia as an argument for new binding rules as regards the duties of boards of directors and the composition of the board in, for example, Sweden, is far from evident.

Based on dividend statistics in the 16 countries (including UK), the Report concludes that it is the characteristics of company legislation which give rise to excessive pay-outs. In so far as may be understood from the Report, a more diverse stakeholder representation (other than those appointed by shareholders and employees) on the board of directors would lower pay-outs, which in turn would

serve the sustainability agenda. The same argument is applied to a reformulation of the profit purpose of companies. In this respect, a number of issues arise. First of all, there are major differences in the company law regimes of these 16 countries, which renders it difficult if not impossible to identify a common explanatory variable. For example, according to the Report, Finland has nearly double the pay-out ratio of Sweden. For anyone familiar with Nordic company law legislation, this does not bring to mind thoughts that company law rules explain the pay-out level, since the company law regimes of Sweden and Finland are nearly identical in all relevant parts. In short, the causality that the Report claims to establish is non-existent.

An overall reflection in this area is also the fact that Sweden, like many other European countries since the infancy of industrialism, has continuously improved, for example, working conditions for employees and environment protection and social conditions for its citizens. Reforms in all areas have been brought about by legislation and other forms of regulation that establishes the boundaries for the operations of companies and typically made possible through the continuous process of value creation in the business sector, generating room for higher incomes and tax revenues. The notion that these important advancements in social and environmental reforms could be achieved through modifications to company law legislation has never been seen as an option.

The proposed reforms are based on a web-based survey involving slightly more than 60 stakeholders, amongst others, interest organisations, and interviews with 16 persons in 12 countries (including UK). It is obvious that this does not nearly approximate what may be required to form the basis for EU or national legislation.

Today, stock markets and the supply of risk capital is global. Since 2005, Europe's share of the global stock market value of non-financial companies has fallen by nearly fifty per cent, while the dominance of the US and China has grown. The total stock market value of all European listed companies today equals probably only one tenth of the global market value. Anecdotally, it may be noted that the combined market value of the 30 largest German listed companies (DAX30) does not rise even to the level of two-thirds of the exchange value of Apple alone.

In the initiative for a European capital market union, other parts of the EU Commission have expressed concern for the lack of efficient supply of risk capital in Europe. This seems irreconcilable with the new initiative by DG JUST, which will create increased uncertainty amongst investors as regards the conditions governing the contribution of risk capital to European companies and additionally undermine corporate access to capital for forward-looking investments. This would be particularly serious at this juncture when recovery from the COVID-19 crisis demands our ability to strengthen the balance sheets of European companies with additional equity capital from the market if Europe is not to continue falling behind the rest of the world in areas such as digital platforms, life sciences and artificial intelligence – industries that require more, and not less, access to risk capital.

Respondents

SELF-REGULATORY BODIES

1. The Swedish Corporate Governance Board (*sw. Kollegiet för svensk bolagsstyrning*)
2. The Swedish Association for Generally Accepted Principles in the Securities Market (*sw. Föreningen för god sed på värdepappersmarknaden*)
3. The Swedish Association of Listed Companies (*sw. Aktiemarknadsbolagens förening*)

BUSINESS ASSOCIATIONS

4. Confederation of Swedish Enterprise (*sw. Svenskt Näringsliv*)
5. Confederation of Danish Industry (*da. DI - Dansk Industri*)
6. The Federation of German Industries (*ge. BDI - Bundesverband der Deutschen Industrie*)
7. The Swedish Federation of Business Owners (*sw. Företagarna*)
8. FAR -The Institute for the Accountancy Profession in Sweden
9. Danish Shipping (*da. Danske Rederier*)
10. The Swedish Institutional Owners Association for Regulatory Issues in the Stock Market (*sw. Institutionella Ägares Förening*)
11. The Swedish Investment Fund Association (*sw. Fondbolagens förening*)

INSTITUTIONAL OWNERS

12. AFA Insurance
13. Alecta
14. AMF
15. The Folksam Group
16. Länsförsäkringar Fonder
17. Skandia Mutual Life Insurance Company
18. Första AP-fonden
19. Andra AP-fonden
20. Tredje AP-fonden
21. Fjärde AP-fonden
22. Sjunde AP-fonden
23. Handelsbanken Fonder
24. Nordea Fonder
25. SEB Fonder
26. Swedbank Robur Fonder
27. Didner & Gerge Fonder
28. Lannebo Fonder