

**RE: European Commission consultation on sustainable corporate governance**

BlackRock<sup>1</sup> is pleased to have the opportunity to respond to the Consultation Document on Sustainable Corporate Governance, issued by the European Commission.

While the European corporate governance ecosystem already has strong stakeholder-focused features, we agree that more can be done. We support the Commission's intent to look at additional policy measures that can reinforce the stakeholder company model, an imperative that was further reinforced over the course of the last twelve months by the COVID-19 crisis. In this letter, we provide comments on the main policy proposals of the European Commission's consultation and outline our shareholder engagement expectations related to stakeholder considerations by companies.

Our views come from the perspective of a long-term shareholder: investing in and engaging with investee companies on behalf of our institutional and individual asset owner clients. Many individuals and households use asset management products, such as collective investment funds, to help pursue life goals such as buying a home and saving for retirement. Institutional asset owners, from banks to pension plans to insurers, corporates and charities, use asset managers to manage risk for businesses, serve retirees, and earn an investment return to finance business, scientific, cultural, and charitable pursuits. As intermediaries between sources and uses of capital, asset managers help mobilise and allocate capital to help businesses grow, creating jobs and enabling economies to prosper.

Shareholder engagement by asset managers such as BlackRock typically focuses on issues that support sustainable long-term performance, such as board composition and effectiveness, executive pay, governance, environmental issues, and human capital management. Asset managers do not use their voice to dictate business decisions, which are the responsibility of company boards and management, but to ensure their clients', the end-investors', interests are represented. Simply put, asset managers engage with the companies in which they invest on behalf of clients to protect and advance their clients' economic interests, not their own.

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<sup>1</sup> BlackRock is one of the world's leading asset management firms. We manage assets on behalf of institutional and individual clients worldwide, across equity, fixed income, liquidity, real estate, alternatives, and multi-asset strategies. Our client base includes pension plans, endowments, foundations, charities, official institutions, insurers and other financial institutions, as well as individuals around the world. BlackRock identification number on the EU Transparency Register: 51436554494-18.

## Key points

- BlackRock is convinced of the wider benefits a company's long-term value creation brings and the extent to which its prospects for growth are tied to its ability to foster strong, sustainable relationships with stakeholders.
- The premise of the consultation that all institutional investors are focused on short-term financial considerations in their engagement with investee companies is false. Equally, the idea that 'purely financial' considerations are separate from consideration of wider stakeholder concerns when many companies take decisions does not resonate with our experience.
- In our view, to support long-term value creation, company directors must consider in their corporate decision-making the interests of all their key stakeholders and integrate sustainability considerations into the company's strategy, decisions and oversight. We therefore agree with the Commission's proposals that companies should identify their key stakeholders, take due regard of their interests in corporate decisions, and manage the risks and identify the opportunities arising from integrating stakeholders' interests.
- But striking a balance between a company's accountability to shareholders and its responsibility to other stakeholders is important. Economic ownership of shares in a company comes with certain rights and responsibilities, which are in turn essential to an effective principal/agent relationship that underpins good governance. Creating legal rights, such as the proposed formal role in the enforcement of directors' duty of care, for stakeholders who are not capital providers could undermine some of the cornerstone concepts on which many corporate governance and company law frameworks are built.
- We support the creation of a pan-European framework for supply chain due diligence for EU-based companies, relying on international standards (such as the United Nations' Guiding Principles on Businesses and Human Rights and the OECD Guidelines for Multinational Enterprises and its Due Diligence Guidance for Responsible Business Conduct). This broad due diligence framework can be complemented with a flexible sector-based approach to allow companies to adapt to the specificities of their sector. Disclosure requirements on the company's due diligence (possibly through the upcoming Non-Financial Reporting Directive proposal) can provide an efficient mechanism for shareholders and other stakeholders for engagement.
- We recommend the European Commission considers avenues to enhance equity share ownership by employees with appropriately structured share ownership plans that give this critical stakeholder group greater economic interest in the company. Such programmes could equally help reinforce some of the aims of the Capital Markets Union.
- Corporate governance in Europe is an intricate web of legacy features, company-specific, national and regional rules and cultural norms, as set out in our *ViewPoint* "Europe's Listed Companies".<sup>2</sup> Shareholders in European companies are highly diversified, from individuals to national governments, strategic individuals and founding families, companies themselves and institutional investors. While we see merit in creating a pan-EU framework for sustainable corporate governance, we recommend the Commission considers the highly diversified nature of this ecosystem.

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<sup>2</sup> BlackRock *ViewPoint*, 2020, "Europe's listed companies: their governance, shareholders and votes cast." <https://www.blackrock.com/corporate/literature/whitepaper/viewpoint-europe-listed-companies-governance-shareholders-votes-cast-february-2020.pdf>

## **An investor perspective on stakeholder considerations by company boards**

As an asset manager investing in European and non-European companies on behalf of institutional and individual asset owners with long-term investment horizons, BlackRock expects that companies operate with a long-term mindset to create sustainable value. To do this, we believe that companies should take due account of the interests of shareholders and other key stakeholders, as well as external factors, including preparing for a net zero economy. Balancing the interests of other key stakeholders and shareholders recognises the nature of long-term value creation and reflects our belief that companies' prospects for growth are tied to their ability to foster strong sustainable relationships with their stakeholders.

Many of the policy options considered in the consultation paper, which focus on further reinforcing companies to take all key stakeholder interests into account, echo many shareholders' expectations, BlackRock's included. As an engaged shareholder, we ask that the companies we are invested in on behalf of our clients report on how they have determined their critical stakeholders and considered their interests in business decision-making. We also ask that companies effectively address adverse impacts that could arise from their business practices and mitigate material risks with appropriate due diligence processes and board oversight.<sup>3</sup> We expect this to be complemented with relevant disclosures by investee companies to help shareholders inform their shareholder engagement and investment analyses.

We are supportive of a number of ideas put forward in the proposal, including that:

- Sustainability and stakeholder considerations should be integrated into the company's strategy, decisions and oversight within the company.
- Companies and directors should take due regard of their main stakeholders' interest in corporate decisions.
- An EU legal framework for supply chain due diligence, built on the existing international standards, to address adverse impacts on human rights and environmental issues should be developed.

We also agree with the intention of the proposal that companies should be required to i) identify the company's stakeholders and their interests, manage the related risks and to identify the opportunities, and ii) set up procedures and, where relevant, measurable targets to ensure that possible risks and adverse impacts on stakeholders are identified and addressed. We note, however, that non-executive directors oversee management and do not set operating procedures. Therefore, we believe the proposed requirements should apply to executive directors or senior management with overall oversight by the board.

Finally, we caution against creating clear delineations in policy between 'shareholder interests' and 'stakeholder interests' as if these are differing, or even opposite bases on which companies take decisions. This is, in our view, a false dichotomy as shareholders are also stakeholders.

**As explained in our Chair and CEO's letter to CEOs of investee companies in 2020, "a company cannot achieve long-term profits without embracing purpose and considering the needs of a broad range of stakeholders. [...] A strong sense of purpose and a commitment to stakeholders helps a company connect more deeply to its**

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<sup>3</sup> BlackRock, "Our 2021 Stewardship Expectations: Global Principles and Market-level Voting Guidelines", 2020.

<https://www.blackrock.com/corporate/literature/publication/our-2021-stewardship-expectations.pdf>

customers and adjust to the changing demands of society. Ultimately, purpose is the engine of long-term profitability.”<sup>4</sup>

Over the course of 2020, we have seen, both through reported company performance and our own shareholder engagement, how purposeful companies with strong profiles on material sustainability issues have outperformed their peers with weaker profiles.<sup>5</sup> We are aware – and supportive – of the need for companies to translate words into action in looking after the interests of all their stakeholders.

Being connected to stakeholders – establishing trust and shared purpose – enables a company to understand and better respond to the changes happening in the world. Companies ignore stakeholders at their peril. Companies that do not earn this trust will find it harder and harder to attract customers and talent, especially as a growing number of people increasingly expect companies to reflect their values. **The more a company can show its purpose in delivering value to its customers, its employees, and its communities, the better able it will be to compete and deliver long-term durable profits for shareholders.**

## **Striking the balance between accountability to shareholders and responsibility to other stakeholders**

As we have outlined above, we believe that stakeholder interests should be an important consideration for companies in their decision-making, and that processes should be in place to ensure that potential risks on stakeholder-material sustainability issues are addressed.

That said, we recognise the challenge in legally defining, at the EU level, the duty of the board to have regard to stakeholder interests, while balancing the legal accountability directors have towards the owners of the company, i.e. its shareholders (an accountability set in Member States’ company laws). **An important distinction between shareholders and other stakeholders is that companies are accountable to the former and have responsibilities towards the latter.** EU policymakers should avoid setting ex-post enforcement measures by non-shareholder stakeholders to ‘police’ directors in the exercise of their duty of care.

Providing specific external stakeholder groups with a formal role in enforcing directors’ duty of care can create unintended consequences:

- It could conflate the role of capital providers (such as shareholders) with those that are not, thus diluting the accountability the board has towards shareholders, a cornerstone concept of corporate governance and company law.
- It would broaden liability risks for directors, with a likely effect on companies being unable to attract directors with appropriate skills and experience.
- In diluting the accountability mechanisms that shareholders have towards companies, it could potentially increase the cost of capital to companies if investors price in governance changes.

In addition to disclosure mechanisms to complement due diligence requirements (detailed below), we believe that other avenues exist to reinforce stakeholder groups’ engagement with the company, such as community engagement, whistleblowing mechanisms, and employee share ownership. We recommend the Commission considers promoting employee share ownership with appropriately structured share ownership

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<sup>4</sup> Larry Fink, CEO letter, 2020. <https://www.blackrock.com/us/individual/larry-fink-ceo-letter>

<sup>5</sup> BlackRock, “Sustainable investing: resilience amid uncertainty”, 2020. <https://www.blackrock.com/corporate/about-us/sustainability-resilience-research>

plans that give this critical stakeholder group greater economic benefits from the company. Due regard should be taken of employees' interests as shareholders, including providing adequate advice about the nature of their investments. This would have the added benefits of supporting the equity investment objectives of the Capital Markets Union agenda.

## Due diligence

Institutional investors such as BlackRock expect companies to articulate how they address adverse impacts that could arise from their business practices and affect critical business relationships with their stakeholders. In our engagements, where relevant, we communicate this view to companies, and we expect them to implement monitoring and due diligence processes to identify and mitigate potential adverse impacts, including grievance mechanisms to remediate any actual adverse impacts.<sup>6</sup>

As highlighted earlier, the European Commission's proposals around due diligence, to a great degree, complement shareholder expectations, including our own. We support the introduction of an EU-level framework which will facilitate a rigorous approach to supply chain due diligence. This will help raise the bar and give interested parties (companies, shareholders and their other key stakeholders) a common language with which to discuss these issues. As highlighted in the consultation paper, the pan-EU framework should aim to rely on existing due diligence norms such as the United Nations' Guiding Principles on Businesses and Human Rights and the OECD Guidelines for Multinational Enterprises and its Due Diligence Guidance for Responsible Business Conduct. At the same time, the requirements must be flexible enough to adapt to the specificities of different sectors' material supply chain related.

From a shareholder engagement perspective, furthering the understanding of companies and all their stakeholders about what is considered good practice with respect to supply chain due diligence will allow shareholders to better assess how companies in the same sector perform across the jurisdictions in which they operate and to hold them accountable.

From the options laid out in the consultation paper, we believe that a horizontal approach to the due diligence requirement can cover human and labour rights, interests of local communities, climate change mitigation, and natural capital – built on the UN Guiding Principles and OECD Guidelines mentioned above. In providing appropriate flexibility, we believe that the sector-based materiality map of the Sustainability Accounting Standards Board (SASB) framework is an effective blueprint. A sector-specific focus on due diligence (together with the broader horizontal approach) will help companies identify and address company-relevant and decision-useful risks and opportunities (for example, the supply-chain related risks that a clothing manufacturer may be exposed to will be entirely different from a company in the raw materials sector, or in turn, a professional services firm), and put the adequate policies in place.

To make a new due diligence duty more effective, we recommend accompanying them with public disclosure requirements, likely as part of the upcoming Non-Financial Reporting Directive (NFRD) proposal. Disclosures will help shareholders hold companies accountable and hold them responsible towards their other key stakeholders. As noted earlier, institutional investors expect companies to not only undertake the adequate due diligence measures but also to complement them with reporting – which will best allow all

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<sup>6</sup> BlackRock, "BlackRock Investment Stewardship Global Principles", 2021: <https://www.blackrock.com/corporate/literature/fact-sheet/blk-responsible-investment-engprinciples-global.pdf>

their stakeholders to inform their engagement with the company. As such, we view disclosures as an adequate and effective ‘enforcement mechanism’ set at the EU level.

## **Other elements of sustainable corporate governance**

Below we provide additional suggestions or clarifications to other policy options made in the consultation paper.

### **Shareholder engagement oriented towards long-term collective value creation**

As outlined above, we believe a prosperous company over the long term is one that embraces its purpose and has due regard of its stakeholders, including employees, suppliers, customers, communities, indigenous peoples and other interested parties. BlackRock, like many other institutional investors, has adopted an engagement approach to support the creation of long-term sustainable enterprise value by investee companies. As such, we believe that shareholders themselves have a role to play in reinforcing sustainable corporate governance.

This role can be expressed in different ways. Institutional investors, including BlackRock, engage with investee companies on human capital management. Human capital management stimulates a dialogue between the company and shareholders on its purpose and culture, employee engagement, how the company addresses inequalities, employee well-being and health – features which exhibit the stakeholder focused orientation of a company.<sup>7</sup>

Secondly, BlackRock, as an engaged and long-term shareholder, expects remuneration to be aligned with the experience of the company’s key stakeholders. The consultation paper implies that shareholders do not focus on long-term performance in assessing executive pay packages. This has not been our experience. Shareholders frequently look to companies to include non-financial metrics in executive pay packages where this is aligned with the delivery of their strategy and would support long-term enterprise value creation.

### **Sustainability competence of the board**

Experience in sustainability issues as business risks by the board is a clear expectation of shareholders, and we agree with the Commission that more can be done to enhance directors’ competence in this area. It is the board’s responsibility to oversee all risks to the company, including climate and other material sustainability risks, and as such shareholders expect there to be sufficient expertise amongst the directors on sustainability matters. We would in particular favour the proposed requirement for companies to consider environmental, social and/or human rights expertise in the directors’ nomination and selection process and the proposal for the board to regularly assess its level of expertise on environmental, social and/or human rights matters and take appropriate follow-up, including regular trainings. To repeat, we expect fluency on sustainability across the board, rather than captured by the nomination of a ‘sustainability-focused’ director. The entire board should be prepared to provide perspective on sustainability gained from a range of corporate experiences.

### **Stakeholder access to directors through company management**

We suggest companies should publish an engagement protocol setting out how they engage with key stakeholders, including shareholders and employees. This model already exists in certain European countries where non-executive directors engage with employees through a meeting arranged by company management. We would expect the

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<sup>7</sup> See BlackRock Investment Stewardship’s approach to engagement on human capital management. <https://www.blackrock.com/corporate/literature/publication/blk-commentary-engagement-on-human-capital.pdf>



engagement protocol to provide that, when necessary, specific members of the board are available for engagement with the company's stakeholders, such as the workforce, supported by the appropriate members of the management team. This would typically be the most relevant non-executive or independent director to the issue in question, sitting in on a meeting management would have had organised.

## **Short-termism as a central premise to further policy action**

**While we agree with many of the considered outputs, we strongly disagree with the observations made in the consultation that companies are short-termist and shareholder-oriented at the expense of other stakeholders.<sup>8</sup>**

**Equally, another assumption underpinning part of this consultation seems to be that shareholders in European listed companies are predominantly financial institutions whose interests and investment horizons are short-term in nature. This view is incorrect.**

By and large, financial institutions are not the main shareholder group in European companies. In our 2020 *ViewPoint* "Europe's listed companies: their governance, shareholders and votes cast", we examined the share ownership of companies included in the MSCI Europe index.<sup>9</sup> As of December 2019, the majority of their investors (~ 61%) are either non institutional investor owners or unidentified owners:

- 22% are 'non-institutional investors', such as a parent or holding companies, founding families, foundations, public sector, and strategic individuals.
- 39% of ownership remained unidentified (primarily because the shareholdings of institutions or individuals fell below national reporting thresholds).

The remaining 39% of investors in the companies listed in the MSCI Europe index are financial institutions, including both asset owners, such as banks, insurers, pension funds, and asset managers holding assets on behalf of institutions and individuals (for example, through collective investment funds). As underlined earlier in this response, asset managers act on behalf of their clients, towards whom they have a fiduciary duty to protect and enhance their economic interests. When engaging with investee companies, asset managers must act in line with this duty and protect their clients' interests – the individual and institutional asset owners – not their own. In our *ViewPoint*, a country by country break down revealed greater disparity in the proportion of share ownership between financial institutions, unidentified shareholders and the remainder identified ones (exhibit 3, page 6).

To better understand company dynamics and the sources of the perceived short-termism of companies, further studies should integrate governments, individuals, founding families and private companies as major shareholder types and keep in mind that the data of share ownership in the EEA remains limited (although one of the longer-term effects of the revised Shareholder Rights Directive may, to a certain extent, provide greater transparency on shareholder identification).

We would further underline the fact that most asset management companies are not short-termist. With most assets managed dedicated to long-term savings and retirement, a short-term mindset will simply not support their clients', end-investors', financial needs. A long-term mindset is particularly important for asset managers offering index funds,

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<sup>8</sup> See recent academic studies on short termism: ECGI Law Working Paper: "[Short-Termism, Shareholder Payouts, and Investment in the EU](#)"; Alex Edmans, HBR: <https://hbr.org/2017/09/the-case-for-stock-buybacks>

<sup>9</sup> See footnote 2.

which typically remain invested in a stock for as long as it remains in an underlying index, reinforcing the long-term perspective to shareholder engagement.

## **Conclusion**

In closing, we would like to reiterate that we agree with a number of proposals put forward in the consultation on reinforcing sustainability and stakeholder considerations in European corporate governance.

In our experience as an active shareholder engaging with companies across the EU, the European corporate governance landscape is an intricate web of legacy features, company-specific, national and regional rules and cultural norms. While we see merit in creating a pan-European framework for sustainable corporate governance, enough flexibility must be kept in further EU policy action, recognising the highly diversified nature of this ecosystem, not least so that the interests of varied stakeholders can be properly respected.

We look forward to working with the EU policymakers and other stakeholders to advance the aims of improving the corporate governance of European companies, including the integration of sustainability considerations into the legal framework for corporate governance.