Principles for Responsible Investment

CONSULTATION RESPONSE

EU SUSTAINABLE CORPORATE GOVERNANCE CONSULTATION

February 2021

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THE PRINCIPLES FOR RESPONSIBLE INVESTMENT

The United Nations-supported Principles for Responsible Investment (PRI) is the world's leading initiative on responsible investment. The PRI has over 3,000 signatories (pension funds, insurers, investment managers and service providers) globally with approximately US $100 trillion in assets under management.[1]

The PRI works with its international network of signatories to put the six Principles for Responsible Investment into practice. Its goals are to understand the investment implications of environmental, social and governance (ESG) issues and to support signatories in integrating these issues into investment and ownership decisions. The PRI acts in the long-term interests of its signatories, of the financial markets and economies in which they operate and ultimately of the environment and society. The six Principles for Responsible Investment are a voluntary and aspirational set of investment principles that offer a menu of possible actions for incorporating ESG issues into investment practice. The Principles were developed by investors, for investors. In implementing them, signatories contribute to developing a more sustainable global financial system.

The PRI welcomes the opportunity to contribute to the European Commission's consultation on sustainable corporate governance. This consultation response represents the view of the PRI Association and not necessarily the views of its individual members.

More information: www.unpri.org

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[1] See https://www.unpri.org/signatory-directory/

OVERALL STATEMENT

The PRI welcomes the opportunity to provide comment to this consultation on EU sustainable corporate governance and support the Commission's aims to:

- enable companies to focus on long-term sustainable value creation rather than short-term benefits;
- better align the interests of companies, their shareholders, managers, stakeholders and society; and
- help companies to better manage sustainability-related matters in their own operations and value chains as regards human rights, climate change, environment, etc.

The PRI recommends that the Commission:

1. **Provide clarity and consistency on director duties across the EU.** There is no explicit duty in EU law for directors to generally act in accordance with the company's long-term interests, shareholders' views or to incorporate stakeholder interests. As such, the interpretation and precise formulation of directors' duties, and the processes they must take into consideration, varies across member states. Member states' existing legal requirements and use of voluntary corporate governance codes should be taken into consideration in creating greater clarity and consistency. For the PRI, a *sustainable* corporate governance regime means directors consider the interests and needs of shareholders and stakeholders and the social and environmental impact of company operations to allow a more holistic approach for the maximisation of social, environmental, as well as economic/financial performance.

2. **Undertake a rigorous legal and impact analysis to support any EU legislation on director duties**. The analysis should determine the extent to which clarification of directors' duties will result in the desired shift in focus towards long-term sustainability, and how this will also support existing corporate governance regimes that consider stakeholder interests to varying extent across member states.

3. **Establish a legal duty for companies to undertake environmental and human rights due diligence**. Such an EU due diligence duty should be binding on all companies with operations within the EU of a specified size including those not headquartered in the EU and should build on recognised international standards such as the UN Guiding Principles on Business and Human Rights and the OECD Guidelines for Multinational Enterprises. The Commission should also ensure that standards are reflected in member-state legislation to achieve a level playing field across member states. Appropriate accountability and enforcement of the due diligence duty will be necessary to make the duty effective and ensure it provides access to remedy for people subject to harm from corporate activities.

4. **Ensure consistency across proposed reforms within DG JUST and other EU directorates.** It is important that the requirements put forward by different directorates across the EU are complimentary and do not create conflicts in obligations for companies and their directors. For example, DG JUST's proposals should be brought into better alignment with current sustainability disclosure requirements for both companies and investors, as proposed by DG FISMA.

5. **Mandate the incorporation of ESG factors in directors' remuneration to balance the focus on short-term financial metrics in pay packages.** However, the Commission should provide guidance to prevent 'pay padding', backward looking performance targets and other potential unintended consequences.

More detailed answers and recommendations below are in response to selected questions from the consultation that draw on specific expertise and evidence from the PRI's work.

PRI’S RESPONSE TO SELECTED QUESTIONS

Section 1. Need and objectives for EU intervention on sustainable corporate governance

Question 1

Due regard for stakeholder interests’, such as the interests of employees, customers, etc., is expected of companies. In recent years, interests have expanded to include issues such as human rights violations, environmental pollution and climate change. Do you think companies and their directors should take account of these interests in corporate decisions alongside financial interests of shareholders, beyond what is currently required by EU law?

- **<u>Yes, a more holistic approach should favour the maximisation of social, environmental, as well as economic/financial performance.</u>**
- **Yes, as these issues are relevant to the financial performance of the company in the long term.**
- **No, companies and their directors should not take account of these sorts of interests.**
- **Do not know.**

Please provide reasons for your answer.

PRI response:

Issues such as human rights harm, environmental pollution and climate change have relevance both in terms of the financial interests of shareholders and the expectations and rights of other stakeholders. In addition to understanding potential financial risks and opportunities, a focus on social, environmental, as well as economic/financial performance allows both companies and their underlying investors to:

- identify opportunities, such as through changes to business models, across supply chains and through new and expanded products and services;
- prepare for and respond to legal and regulatory developments, including those that may lead to asset stranding;
- protect their reputation and licence-to-operate particularly in the event of negative outcomes from operations;
- meet institutional commitments to global goals such as the Sustainable Development Goals (SDGS), and communicate on progress towards meeting those objectives; and
- minimise negative impacts and increase the positive impacts of products, services and operations.

As a result, a substantial and growing number of investor PRI signatories are now seeking to understand how companies consider these issues and encourage a more holistic approach for the maximisation of social, environmental, as well as economic/financial performance.

We note similar developments being considered by DG FISMA in relation to revision of the non-financial reporting directive (NFRD) and the upcoming investor disclosure requirements under the regulation on sustainability-related disclosures in the financial services sector (SFDR) and Taxonomy regulation. We consider it important to ensure alignment between what is taken into account by company directors through corporate governance reforms, and requirements in investors’ duties, considerations and disclosures on sustainability issues. The sustainable corporate governance initiative should also be consistent with any upcoming revisions to the Shareholder Rights Directive II (SRD II).

Question 2: Human rights, social and environmental due diligence requires companies to put in place continuous processes to identify risks and adverse impacts on human rights, health and safety and environment and prevent, mitigate and account for such risks and impacts in their operations and through their value chain.

In the survey conducted in the context of the study on due diligence requirements through the supply chain, a broad range of respondents expressed their preference for a policy change, with an overall preference for establishing a mandatory duty at EU level.

Do you think that an EU legal framework for supply chain due diligence to address adverse impacts on human rights and environmental issues should be developed?

- **<u>Yes, an EU legal framework is needed.</u>**
- **No, it should be enough to focus on asking companies to follow existing guidelines and standards.**
- **No action is necessary.**
- **Do not know.**

PRI response:

We recommend the EU establish a legal duty for companies to undertake due diligence. International guidelines such as the UN Guiding Principles on Business and Human Rights (UNGPs) as well as the OECD Guidelines for Multinational Enterprises (OECD Guidelines) set out companies' responsibility to conduct due diligence to identify, prevent and mitigate, account for and remedy harm in relation to human rights, environmental issues, and anti-corruption. However, research shows that, almost ten years after their formulation, these standards have been only sporadically adopted by companies. This indicates that voluntary measures and disclosure requirements alone have been insufficient to incentivise companies to act responsibly and mitigate negative consequences for people and the environment and associated risks for both companies and investors.

We observe several examples of due diligence responsibilities being converted into domestic law beginning with modern slavery reporting legislation, as in California, the United Kingdom and now Australia. None of these imposes serious legal penalties for non-compliance. The scope of the French "Duty of Vigilance" law adopted in 2017 goes further to require human rights and environmental due diligence of the largest French companies, and foreign firms with a significant business presence in France. Civil penalties are possible where harm occurs in connection with certain business relationships. The more recent Netherlands Child Labour Due Diligence Act applies to companies that sell or supply goods or services to Dutch end-users, regardless of where they are based or registered, and involves potential criminal penalties for directors.

We recommend that the EU legal framework on supply chain due diligence builds on international standards to ensure alignment with these existing laws and other regimes such as the EU's approach to Corporate Social Responsibility, the minimum safeguards of the EU Environmental Taxonomy and the Regulation on Sustainability-Related Disclosures in the Financial Services Sector. These also draw on key concepts from the OECD guidelines on responsible business conduct for institutional investors aligned to the MNEs guidelines. It is important that the legal framework recognises that companies need to address risks and impacts, not only in their supply chains, but also in their own operations whether in Europe or beyond. A consistent approach will also support international alignment and harmonisation and thus secure a level-playing field for companies operating in the Single Market.

Importantly, a due diligence duty should also cover the financial sector which is bound by the same international standards as has been clarified by both the UN Office of the High Commissioner on Human Rights and the OECD. The PRI supports this understanding.

Question 3: If you think that an EU legal framework should be developed, please indicate which among the following possible benefits of an EU due diligence duty is important for you.

- **<u>Ensuring that the company is aware of its adverse human rights, social and environmental impacts and risks related to human rights violations other social issues and the environment and that it is in a better position to mitigate these risks and impacts</u>**
- **<u>Contribute effectively to a more sustainable development, including in non-EU countries</u>**
- **<u>Levelling the playing field, avoiding that some companies freeride on the efforts of others</u>**
- **<u>Increasing legal certainty about how companies should tackle their impacts, including in their value chain</u>**
- **<u>A non-negotiable standard would help companies increase their leverage in the value chain</u>**
- **<u>Harmonisation to avoid fragmentation in the EU, as emerging national laws are different</u>**
- **<u>SMEs would have better chances to be part of EU supply chains</u>**
- **<u>Other, please specify.</u>**

PRI response:

All the above reasons are strong arguments for introducing an EU due diligence duty binding on companies.

In addition, an EU due diligence duty binding on companies would enable investors to compare corporate performance against this baseline standard for improved investment decisions and stewardship activities, and therefore to drive better financial, economic, environmental and social outcomes.

Question 3a: Please indicate which among the following possible risks/drawbacks linked to the introduction of an EU due diligence duty are more important for you.

- **Increased administrative costs and procedural burden**
- **<u>Penalisation of smaller companies with fewer resources</u>**
- **<u>Competitive disadvantage vis-à-vis third country companies not subject to a similar duty</u>**
- **<u>Responsibility for damages that the EU company cannot control</u>**
- **Decreased attention to core corporate activities which might lead to increased turnover of employees and negative stock performance**
- **Difficulty for buyers to find suitable suppliers which may cause lock-in effects (e.g. exclusivity period/no shop clause) and have also negative impact on business performance of suppliers**
- **<u>Disengagement from risky markets, which might be detrimental for local economies</u>**
- **Other, please specify.**

PRI Response:

We recommend that:

- the Commission introduce an EU due diligence duty, that is shaped according to the UNGPs.
- an EU due diligence duty should be binding on all companies with operations within the EU of a specified size, including those not headquartered in the EU.

- the Commission encourage international standards to be reflected in member-state legislation to ensure a level playing field among member states.

The UNGPs should serve as a valuable basis for an EU due diligence duty for the reasons set out below.

The UNGPs include a proportionality principle which means that the due diligence procedures of SMEs can take a more informal shape than large multinational companies. The UNGPs also set out a framework that companies can use to develop their approach to understanding their impacts and remedy. Companies have a responsibility for impacts that they are 'causing', 'contributing to' and 'directly linked to' as defined by the UNGPs and OECD Guidelines. Where companies cause or contribute to harm, they should act to mitigate and provide remedy. Where companies are directly linked to harm, they should use and build leverage in order mitigate those harms also. The UNGPs and OECD Guidelines advocate addressing harms or risk of harms, over termination of operations or business relationships. If an EU-based company determines that harm they are 'directly linked to' cannot be mitigated, they should consider the consequences of terminating the business relationship, again with the aim of ensuring that they make the decision with the least social and environmental harm.

We recognise that there may be an upfront cost to companies of establishing due diligence procedures. However, in the medium to long-term due diligence will lead to benefits for employees, customers, communities and the environment. Companies that manage sustainability risks and opportunities demonstrate better financial performance and have the potential to strengthen supply chain relationships and resilience.[2] Investors increasingly prioritise companies with a potential positive effect on cost of capital.

Section 2. Directors' duty of care – stakeholders' interests

Question 5: Which of the following interests do you see as relevant for the long-term success and resilience of the company?

	Relevant	Not relevant	I do not know/ I do not take a position
The interests of stakeholders	**Yes**		
The interests on employees	**Yes**		
The interests of employees in the company's supply chain	**Yes**		
The interests of persons and communities affected by the operations of the company	**Yes**		
The interests of persons and communities affected by the company's supply chain	**Yes**		
The interests of local and global natural environmental including climate	**Yes**		

[2] See for example: The Impact of Corporate Sustainability on Organizational Processes and Performance, 2014, Robert G. Eccles, Ioannis Ioannou and George Serafeim, Harvard Business School

The likely consequences of any decisions in the long term (beyond 3-5 years)	**Yes**		
The interests of society, please specify	**Yes**		
Other interests, please specify	**Yes (shareholders)**		

PRI response:

Companies should consider the interests, needs and expectations of all individuals and groups, shareholder and non-shareholder stakeholders who affect or could be affected by an organisation's activities, performance, products and/or services.

There is often alignment between the interests of shareholder and non-shareholder stakeholders. Long-term shareholders recognise that identifying relevant stakeholders, prioritising, balancing and managing their interests is core to the success and resilience of a company. Increasingly long-term investors exercise their stewardship rights and responsibilities to encourage companies to do so, for example via voting and engagement and filing shareholder resolutions on ESG issues.

Question 7: Do you believe that corporate directors should be required by law to set up adequate procedures and where relevant, measurable (science-based) targets to ensure that possible risks and adverse impacts on stakeholders, i.e., human rights, social, health and environmental impacts are identified, prevented and addressed?

- **I strongly agree**
- **<u>I agree to some extent</u>**
- **I disagree to some extent**
- **I strongly disagree**
- **I do not know**
- **I do not take position**

Please provide an explanation or comment.

PRI response:

1. **Adequate procedures**

The EU should build mandatory legal due diligence obligations on existing international standards, including responsibilities on human rights, anti-corruption, tax and environmental risks.

2. **Measurable targets where relevant**

The PRI recognises the importance of companies aligning their corporate strategies and activities with measurable and science-based sustainability goals (see Q15e for recommendations on relevant international sustainability frameworks).

The EU Taxonomy for environmentally sustainable economic activities provides a tool for companies that can be used as the basis to understand the environmental impacts of their activities. A similar taxonomy is currently being considered for social issues under the EU Platform for Sustainable Finance. The European Financial Reporting Advisory Group (EFRAG) is currently tasked with providing technical advice in preparation for a revision of the NFRD. The Regulatory Technical Standards (RTS) considered by the European Supervisory Authorities (ESAs) to inform disclosures under the Sustainable Finance Disclosure regulation rests on these developments.

PRI recommends the European Commission to develop target-based obligations in alignment with the requirements developed through these ongoing processes.

Question 8: Do you believe that corporate directors should balance the interests of all stakeholders, instead of focusing on the short-term financial interests of shareholders, and that this should be clarified in legislation as part of directors' duty of care?

- **<u>I strongly agree</u>**
- **I agree to some extent**
- **I disagree to some extent**
- **I strongly disagree**
- **I do not know**
- **I do not take position**

Please provide an explanation or comment

PRI response:

We strongly agree, <u>subject to an impact analysis.</u>

Subject to rigorous impact analysis, and in addition to a clarification on director duties, including in relation to accountability to shareholders, the PRI is supportive of the Commission's agenda to enable better integration of stakeholders' interests in the way that companies operate and consider sustainability issues.

There is significant alignment between the financial interests of long-term shareholders and the needs and interests of stakeholders, and the PRI and our signatories have regularly advocated for companies to address sustainability risks and opportunities for long-term value creation. For instance, many PRI signatories engage with portfolio companies to address climate change impacts and develop plans to meet Paris commitments on greenhouse gas emissions.

Corporate responsibility to assess and manage human rights and environmental impacts also exists even when they are not necessarily proven to be financially material. This is also aligned with the concept of double materiality in the NFRD. Investors engage on human rights issues and advocate for better practices in the value chain both because this directly relates to the long-term financial interests of shareholders and because investors are increasingly seeking to understand companies' impacts. Therefore, it is important that any proposed change to legal requirements does not relegate accountability of a company to its shareholders. In fact, boards should be developing a transversal sustainability strategy (integrated within overall strategy and with group wide implementation); incorporate relevant stakeholder interests on ESG issues in working towards the strategy; and remain accountable to shareholders on the progress towards the strategy. We note that there may be instances whereby corporate directors will need to balance conflicting interests between groups of shareholders and stakeholders and companies' sustainability impact. It will be important that, in any clarification on directors' duties and the introduction of any mandatory requirements on due diligence, the Commission provides guidance for companies on how to apply a modified understanding of duties and processes.

Therefore, we recommend that the Commission undertake a rigorous legal and impact analysis to support any legislative clarification on directors' duties. The analysis should determine the extent to which clarification of directors' duties will result in the desired shift in focus towards long-term sustainability, and how clarification of directors' duties will support existing corporate governance regimes that consider stakeholder interests to varying extent across member states.

Question 10: As companies often do not have a strategic orientation on sustainability risks, impacts and opportunities, as referred to in question 6 and 7, do you believe that such considerations should be integrated into the company's strategy, decisions and oversight within the company?

- **<u>I strongly agree</u>**
- **I agree to some extent**

- **I disagree to some extent**
- **I strongly disagree**
- **I do not know**
- **I do not take position**

Please explain.

PRI response:

A responsibility to identify, prevent and mitigate negative impacts for people and the environment associated with businesses activities already exists in the UNGPs and OECD Guidelines, as specified earlier, and this should be reflected in EU legislation.

This responsibility should be integrated into the company's strategy and embedded throughout the different functions of the organization. Clear targets and time-bound plans should be put forth along with accountability mechanisms to make sure they are met. Oversight from the board and C-suite should also be ensured.

Section 3: 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 the 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.

PRI response:

Yes, we agree with the definition subject to technical considerations.

1. The 'directly linked to' aspect of the UNGPs and OECD Guidelines which covers most business relationships, should be included.
2. The legislation should explicitly refer to value chains rather than supply chains which also covers customers and downstream relationships.
3. The responsibility to provide access to remedy should be included.
4. The use of severity would be helpful to assist companies in determining appropriate actions.

Question 15: Please indicate your preference as regards the content of such possible corporate due diligence duty. (tick the box, only one answer possible). Please note that all approaches are meant to rely on existing due diligence standards, such as the OECD guidance on due diligence or the UNGPs. Please note that Option 1, 2 and 3 are horizontal i.e. cross-sectorial and cross thematic, covering human rights, social and environmental matters. They are mutually exclusive. Option 4 and 5 are not horizontal, but theme or sector-specific approaches. Such theme specific or sectorial approaches can be combined with a horizontal

approach (see question 15a). If you are in favour of a combination of a horizontal approach with a theme or sector specific approach, you are requested to choose one horizontal approach (Option 1, 2 or 3) in this question.

- **Option 1. "Principles-based approach": A general due diligence duty based on key process requirements (such as for example identification and assessment of risks, evaluation of the operations and of the supply chain, risk and impact mitigation actions, alert mechanism, evaluation of the effectiveness of measures, grievance mechanism, etc.) should be defined at EU level regarding identification, prevention and mitigation of relevant human rights, social and environmental risks and negative impact. These should be applicable across all sectors. This could be complemented by EU level general or sector specific guidance or rules, where necessary.**
- **Option 2. "Minimum process and definitions approach": The EU should define a minimum set of requirements with regard to the necessary processes (see in option 1) which should be applicable across all sectors. Furthermore, this approach would provide harmonised definitions for example as regards the coverage of adverse impacts that should be the subject of the due diligence obligation and could rely on EU and international human rights conventions, including ILO labour conventions, or other conventions, where relevant. Minimum requirements could be complemented by sector specific guidance or further rules, where necessary.**
- **Option 3. "Minimum process and definitions approach as presented in Option 2 complemented with further requirements in particular for environmental issues". This approach would largely encompass what is included in option 2 but would complement it as regards, in particular, environmental issues. It could require alignment with the goals of international treaties and conventions based on the agreement of scientific communities, where relevant and where they exist, on certain key environmental sustainability matters, such as for example the 2050 climate neutrality objective, or the net zero biodiversity loss objective and could reflect also EU goals. Further guidance and sector specific rules could complement the due diligence duty, where necessary.**
- **Option 4 "Sector-specific approach": The EU should continue focusing on adopting due diligence requirements for key sectors only.**
- **Option 5 "Thematic approach": The EU should focus on certain key themes only, such as for example slavery or child labour.**
- **None of the above, please specify**

PRI Response:

Option 3.

Question 15a: If you have chosen option 1, 2 or 3 in Question 15 and you are in favour of combining a horizontal approach with a theme or sector specific approach, please explain which horizontal approach should be combined with regulation of which theme or sector?

PRI Response:

The UNGPs and the OECD Guidelines should form the basis for the approach across all sectors.

We recommend that the Commission ensures alignment and integration with other thematic or sector-specific regulatory frameworks such as existing regulation on modern slavery, child labour and deforestation.

Additional guidance for European companies should, where possible, be based on existing international standards such as OECD sectoral due diligence guidance for multinational enterprises around agriculture, apparel, and mineral supply chains.

Question 15b: Please provide explanations as regards your preferred option, including whether it would bring the necessary legal certainty and whether complementary guidance would also be necessary.

PRI Response:

Companies' compliance with the UNGPs and OECD Guidelines vary considerably, and overall remains low. This is well documented by the World Benchmarking Alliance and others.

A clear legal due diligence requirement would provide clarity to European companies, investors and other stakeholders and foster a level playing field. The NFRD should reflect the due diligence requirements to ensure company accountability through their disclosures.

Human rights and environmental issues will manifest themselves differently across sectors and geographies, and there is plenty of guidance available to companies. See previous answer on the importance of building on existing sector specific guidance and regulation.

Question 15c: If you ticked options 2) or 3) in Question 15 please indicate which areas should be covered in a possible due diligence requirement (tick the box, multiple choice)

- **Human rights, including fundamental labour rights and working conditions (such as occupational health and safety, decent wages and working hours)**
- **Interests of local communities, indigenous peoples' rights, and rights of vulnerable groups**
- **Climate change mitigation**
- **Natural capital, including biodiversity loss; land degradation; ecosystems degradation, air, soil and water pollution (including through disposal of chemicals); efficient use of resources and raw materials; hazardous substances and waste**
- **Other, please specify**

PRI Response:

Other, please specify: Anti-corruption; tax; efficient use of resources should include use of plastics; and marine issues should be included alongside land degradation.

Question 15e: If you ticked option 3) in Question 15, and with a view to creating legal certainty, clarity and ensuring a level playing field, what substantial requirements regarding human rights, social and environmental performance (e.g., prohibited conducts, requirement of achieving a certain performance/target by a certain date for specific environmental issues, where relevant, etc.) should be set at EU level with respect to the issues mentioned in 15c?

PRI Response:

In relation to addressing negative impacts on human rights, the environment and anti-corruption through mandatory due diligence processes, the UN Guiding Principles on Business and Human Rights and OECD Guidelines for Multinational Enterprises should be used as the standards.

In terms of targets, we recommend the following additional frameworks and standards could be used to encourage boards to set mid to long term sustainability performance objectives and non-legally binding targets, at this stage, as explained in question 7:

- Climate change: The Paris Agreement should form the basis.
- Biodiversity loss: This should align with the targets and thresholds in the Post 2021 Global Biodiversity Framework which is being negotiated at the CBD COP this year.
- Chemicals: REACH should be used as a minimum.
- Plastics: EU Plastic Strategy and Circular Economy action plan should be referenced.
- Deforestation: This should be aligned with new EU legislation under consideration.
- Anti-corruption: This should be in line with the UN Global Compact principle 10 - businesses should work against corruption in all its forms, including extortion and bribery.
- Tax: Business should demonstrate strong global commitment against tax avoidance and evasion practices in alignment with international frameworks such as the OECD BEPS initiative and the OECD Guidelines for Multinational Enterprises.

Question 16: How could companies'- in particular smaller ones'- burden be reduced with respect to due diligence? Please indicate the most effective options (tick the box, multiple choice possible).
This question is being asked in addition to question 48 of the Consultation on the Renewed Sustainable Finance Strategy, the answers to which the Commission is currently analysing.

- **All SMEs should be excluded**
- **SMEs should be excluded with some exceptions (e.g. most risky sectors or other)**
- **Micro and small sized enterprises (less than 50 people employed) should be excluded**
- **Micro-enterprises (less than 10 people employed) should be excluded**
- **SMEs should be subject to lighter requirements ("principles-based" or "minimum process and definitions" approaches as indicated in Question 15)**
- **SMEs should have lighter reporting requirements**
- **Capacity building support, including funding**
- **<u>Detailed non-binding guidelines catering for the needs of SMEs in particular</u>**
- **Toolbox/dedicated national helpdesk for companies to translate due diligence criteria into business practices**
- **Other option, please specify**
- **None of these options should be pursued**
- **Please explain your choice, if necessary.**

PRI response:

It is important to recognise that the smaller the company, the more informal policies and procedures will be. In 2012, the European Commission already released guidance specifically for SMEs – "*My Business and Human Rights – A guide to human rights for small and medium-sized enterprises"* – and similar guidance for due diligence on other sustainability issues will be required.

Question 17: In your view, should the due diligence rules apply also to certain third country companies which are not established in the EU but carry out (certain) activities in the EU?

- **<u>Yes</u>**
- **No**
- **I do not know**

PRI response:

Yes. Otherwise, it will create competition problems.

Question 18: Should the EU due diligence duty be accompanied by other measures to foster more level playing field between EU and third country companies?

- **<u>Yes</u>**
- **No**
- **I do not know**

Please explain.

PRI response:

Yes. We would recommend that the EU advocates for similar regulation internationally to drive consistency in responsible business behaviour.

Question 19a: If a mandatory due diligence duty is to be introduced, it should be accompanied by an enforcement mechanism to make it effective. In your view, which of the following mechanisms would be the most appropriate one(s) to enforce the possible obligation (tick the box, multiple choice)?

- **<u>Judicial enforcement with liability and compensation in case of harm caused by not fulfilling the due diligence obligations</u>**
- **Supervision by competent national authorities based on complaints (and/or reporting, where relevant) about non-compliance with setting up and implementing due diligence measures, etc. with effective sanctions (such as for example fines)**
- **Supervision by competent national authorities (option 2) with a mechanism of EU cooperation/coordination to ensure consistency throughout the EU**
- **Other, please specify**

Please provide explanation:

PRI response:

An appropriate accountability and enforcement mechanism is essential to ensure compliance with proposed legislation. This should accompany disclosure through the NFRD. We would also encourage the European Commission to review the success of the liability regime in France following the Duty of Vigilance Law.

The mandate for enforcement must be given to the most suitable authority. Supervisory functions – such as the National Contact Points (NCP) of the OECD – have limited merit and capacity in successful enforcement. We would therefore look favourably on a judicial enforcement regime with liability and compensation subject to a proper examination of learnings from similar national approaches. The need to provide access to remedy for people subject to harm from corporate activities should be given due weight in these considerations.

Section 4. Other elements of sustainable corporate governance

Stakeholder engagement. Better involvement of stakeholders (such as for example employees, civil society organisations representing the interests of the environment, affected people or communities) in defining how stakeholder interests and sustainability are included into the corporate strategy and in the implementation of the company's due diligence processes could contribute to boards and companies fulfilling these duties more effectively.

Question 20a: Do you believe that the EU should require directors to establish and apply mechanisms or, where they already exist for employees for example, use existing information and consultation channels for engaging with stakeholders in this area?

- **I strongly agree**
- **<u>I agree to some extent</u>**
- **I disagree to some extent**
- **I strongly disagree**
- **I do not know**
- **I do not take position**

Please explain.

PRI response:

It is reasonable for companies to have flexibility to select the appropriate mechanism based on individual characteristics such as board size and structure as well as strategic priorities. In some cases, companies can use existing mechanisms to collect feedback from stakeholders such as those established through the EU whistleblowing Directive. In other cases, it may be appropriate to set up a channel for stakeholders separate to those for employees, so that relevant functions of the business can take an active role in addressing and responding to stakeholder concerns.

Introducing a formal mechanism to channel stakeholder views and concerns across global operations will strengthen the voice of stakeholders in the boardroom and the likelihood of incorporation of their input into strategic and operational business decisions. Such mechanisms for two-way dialogues will provide an avenue for companies to understand and respond to legitimate stakeholder views and concerns. Over time, if done right, this will build trust, increase business preparedness and secure a license to operate.

Question 20b: If you agree, which stakeholders should be represented? Please explain.

PRI response:

Companies should develop a framework to prioritise stakeholders based on specific mapping, reflecting their influence and impact. They should also have processes in place to regularly review this list based on the company's long-term strategy and steps towards implementation. Relevant stakeholders could include customers, suppliers, communities, government and trade unions and civil society organisations.

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. 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 analysing. Ranking 1-7 (1: least efficient, 7: most efficient)

	Ranking
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	**7**
Mandatory proportion of variable remuneration linked to non-financial performance criteria	**1**
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	**7**
Other option, please specify	
None of these options should be pursued, please explain	

Please explain.

PRI response:

We recommend that incorporation of ESG factors is mandated to balance the focus on short-term financial metrics in pay packages and that the Commission provides guidance to prevent 'pay padding', backward looking performance targets and other potential unintended consequences.

Executive pay should be aligned with corporate strategy and performance to drive value creation, and the PRI considers that linking ESG performance to pay can help hold executive management to account for the delivery of sustainable business goals.

However, existing remuneration packages do not promote sustainable value creation, instead sometimes creating incentives contrary to this objective. Often, even where ESG factors are incorporated into pay by companies, they do not reflect the ESG priorities for the business nor do they form a meaningful component of the overall remuneration framework.

In determining ESG linked pay, we have three recommendations for companies to counter short-term focus.

1. **Integrate appropriate sustainability criteria into executive remuneration**

Boards should have the discretion to select relevant ESG factors and the appropriate balance of these factors in the remuneration package. It is reasonable to expect that this process would take into account material impacts on business operations, e.g. climate change for fossil fuel intensive industries, and that such factors are incorporated, to some extent, in executive remuneration packages. We have not identified evidence that mandating a specific proportion of ESG-linked pay addresses the issues outlined above constructively. In fact, it could be sub-optimal and result in unintended consequences such as companies over-weighting ESG factors that may be easier to quantify, or adopt operational targets that would be easily met through the course of the business (e.g. in relation to compliance).

2. **Disclose the process for setting ESG linked executive remuneration and policies on adjustments**

Where companies face challenges in identifying the right metrics or targets for certain ESG issues, they should endeavour to disclose these issues, in addition to describing the process undertaken, so investors and stakeholders can understand the rationale and meaningfully input into the process. In addition, the remuneration committee should be able to use their discretion and tools such as clawback provisions to adjust remuneration following unusual events.

3. **Take the wider workforce into account**

Remuneration committees should give due consideration to the conditions and pay of the wider workforce when setting director remuneration to ensure proportionate pay policies and structures are in place. Companies are already required by the SRD II to explain in their remuneration policy how pay and employment conditions of employees were taken into account when establishing the remuneration policy. As a next step, companies should demonstrate tangibly how these considerations have been taken into account by identifying pertinent metrics to link to executive pay packages.

In recent months, the pandemic has highlighted the need for companies to reign in excessive bonuses and stock grants to prevent stark divergences in the outcomes for workers and executives. Companies should proactively take steps to adjust executive rewards and ensure alignment with the broader workforce remuneration. For instance, pay ratio could be used as one input to decision making around remuneration. It can prompt dialogue where year-on-year increase in the ratio is not justified by methodological differences or changes in business operations.

Question 22: Enhancing sustainability expertise in the board. Current level of expertise of boards of directors does not fully support a shift towards sustainability, so action to enhance directors' competence in this area could be envisaged. Please indicate which of these options are in your view effective to achieve this objective (tick the box, multiple choice).

- <u>**Requirement for companies to consider environmental, social and/or human rights expertise in the directors' nomination and selection process**</u>
- **Requirement for companies to have a certain number/percentage of directors with relevant environmental, social and/or human rights expertise**
- **Requirement for companies to have at least one director with relevant environmental, social and/or human rights expertise**
- <u>**Requirement 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**</u>
- **Other option, please specify**
- **None of these are effective options**

Please explain:

PRI response:

The PRI supports enhanced expertise at the board level on sustainability matters.

Corporate boards should have the necessary skills and experience to develop sustainability strategies and ensure appropriate oversight and response to sustainability risks and opportunities. This will also enable strong and constructive engagement with institutional investors that integrate these factors in their investment decision-making.

It is important that ESG competencies exist across the board and are not limited to one board member. Companies should actively seek out expertise on sustainability issues as relevant to business operations, perspectives of stakeholders and financial considerations, in nominating and selecting directors. Board skills matrices may assist in assessing spread of knowledge and experience on the board and any gaps that must be addressed through board renewals. Over time, companies should ensure that a majority of board members are adept at sustainability issues and should be assessed via board evaluation questionnaires to ascertain the same.

In order to ensure robust oversight of sustainability issues, all board members should receive regular and ongoing training in line with an assessment of members' skills and needs. This proactive training may also be supplemented with reactive training triggered by events such as, for example, mergers and acquisitions, or in response to systemic issues such as the urgent need to tackle climate change or stakeholder concerns. Board members should also receive detailed briefings on performance against sustainability goals and strategy from the leadership team, and have access to independent external counsel as needed.