

# Clients & Friends Memo

## European Commission Consultation on the Renewed Sustainable Finance Strategy

28 April 2020

### Introduction

On 8 April 2020 the European Commission published a [consultation paper](#) on its renewed sustainable finance strategy (the “**Sustainability Strategy**”). The Sustainability Strategy is a policy framework forming a key part of the [European Green Deal](#), the EU's roadmap to making the EU's economy sustainable, including reducing net greenhouse gas emission to zero by 2050. Despite the inevitable recent shift of focus to measures dealing with the COVID-19 crisis, this remains a top EU priority and the outcome of this consultation may significantly affect the corporate law applicable to European businesses, investors and directors in the near term.

This wide-ranging consultation seeks the views of interested stakeholders on the measures necessary to increase private investment in sustainable projects. It asks for both general and specific feedback on how best to ensure this flow of capital, including through reporting, transparency and corporate governance requirements. The feedback received will be factored into the Sustainability Strategy, currently expected to be adopted in the second half of 2020. The consultation is open through 15 July 2020.

### Background

The EU expects to be the world leader in the fight against climate change. On 28 November 2019, the European Parliament [declared a climate emergency](#), and on 4 March 2020 the European Commission proposed a European [Climate Law](#), aimed at turning the political commitment of climate-neutrality by 2050 into a legal obligation.

The Sustainability Strategy consultation paper acknowledges that the investment necessary to reach the current climate and energy targets is “massive”, beyond the capacity of the public sector, and moreover that if the climate and biodiversity crises are to be successfully addressed and reversed before potentially dangerous tipping points are reached, much of the investment needs to happen in the next 5-10 years.

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Despite a raft of initiatives already underway at a national and supra-national level (including the EU's original 2018 [Action Plan on Financing Sustainable Growth](#), which laid down the foundations for channelling private capital towards sustainable investments) and the vastly increased investor appetite for sustainable investments in recent years, this consultation recognises that the financial system as a whole is not changing fast enough to support sustainable business and businesses transitioning to sustainability. The revised Sustainability Strategy is expected to be more comprehensive and ambitious, aimed at changing the way businesses analyse and report on their operations and finances, pay directors, make decisions and raise funds, and the way investors assess and engage with businesses, to move sustainability to the centre of all of those processes.

### **The Consultation**

The consultation asks for views on a wide array of questions categorised into three areas (i) strengthening foundations for sustainable investment; (ii) increasing opportunities for citizens, financial institutions and corporates to enhance sustainability; and (iii) reducing and managing climate and environmental risks.

The 102 questions of the consultation give interested parties the opportunity to give their views on some of the most hotly debated questions in corporate finance right now. Among many other interesting topics, this consultation seeks views on several important areas of corporate governance:

- *Company Reporting and Transparency.* Improved information flow is considered a key part of the transition to sustainability. Several countries, including the UK, have recognised the importance of reliable and consistent non-financial reporting to channelling investment to sustainable business (see our memo on the FCA's consultation on climate-related disclosure requirements for listed companies [here](#)). The EU is currently [consulting](#) on a review of the Non-Financial Reporting Directive, and is seeking to provide some standardisation of what is meant by "sustainable" business through its political agreement in relation to a [Sustainability Taxonomy](#) (see our memo [here](#)). The consultation asks for stakeholders' views on the desirability of developing a common, publicly-available, free-of cost environmental data space for companies' ESG information.
- *Long Termism and Stakeholder Corporate Governance.* The consultation reiterates that companies and investors need to integrate long-term horizons and sustainability in their decision-making processes in order to reach sustainability goals. The consultation asks for recommendations on fostering long-termism and for feedback on measures to "tackle short-termism", among them explicit legal provisions on sustainability for credit institutions, and defining clear objectives on portfolio turn-over ratios and holding periods for institutional investors. The consultation paper touches on the related question of so-called "stakeholder governance", and notes with approval the decision of many companies in the EU to prioritise interests of key stakeholders, in particular employees, customers and suppliers, over short-term shareholder interest. Unclear from the consultation is the view of the EU on whether

stakeholder, environmental or societal interests are an element of, or should be prioritised over, long-term shareholder interests. Noting that regard to a range of non-shareholder stakeholder interests has long been a “social expectation” on companies, the consultation asks if human rights violations, environmental pollution and climate change should be added in law as matters of which directors must take account, alongside financial interests of shareholder.

- *Shareholder Engagement and Voting.* Shareholder engagement, and the holding of companies to account by their shareholders, is a key objective of several recent EU initiatives including the [Shareholder Rights Directive II](#). The consultation opens the question of whether more could be done to facilitate long-term engagement, and asks if voting frameworks across the EU should be harmonised to this end, in particular whether the EU should take action to ensure investors can vote on companies’ environmental and social strategies or performance.
- *Director Remuneration.* Under the Shareholder Rights Directive II, directors’ variable remuneration should be based on both financial and non-financial performance where applicable. The consultation seeks views on setting a particular portion of such remuneration which must be linked to non-financial metrics, and whether carbon emission reductions where applicable should be required to be included in companies’ lists of factors affecting such remuneration.

## Conclusion

Despite the current challenges posed by the COVID-19 pandemic, the European Commission continues to focus on sustainability and its ambition to become the first carbon neutral bloc in the world by 2050 (which is at the heart of the European Green Deal). The implementation of the various EU initiatives highlighted above, including the Sustainability Strategy, will lead to a number of legislative and regulatory changes during the remainder of 2020, 2021 and beyond, and will no doubt affect how financial institutions, corporates, directors and stakeholders interact with one another and conduct themselves. We will continue to monitor any developments in this space so that we can respond quickly to any questions our clients may have (or issues they may face) as the impact of certain legislative and/or regulatory changes becomes clear.

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If you have any questions, please feel free to contact any of the following Cadwalader attorneys.

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