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Focus on sustainability – looking at 2020 so far

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Sustainability interests and environmental, social and governance (ESG) factors have become mainstream and are an increasing area of attention for companies. Recent developments, in particular the COVID-19 pandemic and the rise of the BLM movement, cast more light on corporate resilience, purpose and responsibility and on companies' impact on their stakeholders, the wider society and the environment. So how will corporates and financial institutions navigate the many policy areas, dilemmas and views that relate to sustainability? And how should boards view their ESG duties and responsibilities in the context of recent developments?

In this article, we discuss some of the most eye-catching legislative sustainability developments in the first half of 2020. We look at the 2020 AGM season, Dutch and European legislation, and the current focus of financial supervisory authorities on sustainability risks.

Developing an ESG strategy

Recent research conducted by Shawn Cooper (Russell Reynolds Associates) and Sarah Keohane Williamson (CEO of FCLTGlobal), published by the Harvard Law School Forum on Corporate Governance, shows that companies oriented around a long-term time horizon, while also delivering against short-term objectives, outperform their peer companies in terms of revenue, earnings, economic profit, market capitalisation, raising capital, attracting talent, and creating jobs. These companies also rebound faster after an economic downturn. Although views about the impact of ESG vary widely, it is not surprising that directors and boards have taken a keen interest in sustainability and ESG matters, especially in the current, rapidly changing environment at both the local and global levels.

This view is shared and supported by many financial institutions, as they increase their focus on sustainability initiatives and ESG factors. As part of this, financial institutions want additional and more detailed disclosure from companies on ESG indicators in their reporting. There is no uniform and unambiguous approach on what this disclosure should look like because of the fragmented legal landscape. At the same time, there are many legislative initiatives pending that aim to facilitate an easier and better comparison between companies on sustainability and ESG factors and indicators. However, these legislative plans do not always seem to be aligned. For example, varying initiatives regarding implementation deadlines, sustainability indicators and technical implementation requirements can make it difficult for companies to decide on their strategy and approach. Also, the availability of accessible, reliable and comparable data on ESG factors and indicators poses a real challenge for timely compliance. That said, ignoring the potential impact of stakeholder expectations and legislative developments may in itself become a compliance risk. It is increasingly important for companies to develop a sustainability strategy and to take a holistic approach towards risk management and investment decisions. This will help integrate sustainability and ESG factors into an overall risk and reporting framework.

2020 AGM season

Let's have a look at the 2020 AGM season in the Netherlands, affecting the first AGMs held after the implementation of the European Shareholders Right Directive (SRD). Most listed companies need to propose a new remuneration policy for both the management board and the supervisory board. In compliance with SRD, these policies also have to describe how the level of support in society is taken into account in relation to remuneration. By and large, this aspect was not problematic for most shareholders who were primarily focused on the monetary aspects of remuneration.

Another notable development saw most of the AEX companies setting climate-related targets or ambitions. Twelve listed companies have even set out to become fully carbon-neutral. According to the Eumedion 2020 AGM Season Evaluation, some have set this ambition on the basis of looking far ahead at 2050 (Shell, DSM, AkzoNobel, Boskalis and Vopak). Others aim for 2020 (Philips and Signify), 2025 (ASML), 2030 (KPN, Arcadis), 2035 (NSI) or 2039 (Unilever).

During the 2020 AGM season, we noticed an increased ESG engagement by proxy-voting agencies. ISS, for example, published its Climate Voting Policy for investors wanting to incorporate climate-related interests into their portfolio engagement and voting decision-making. Among other things, ISS recommends voting against the appointment of board members at companies which do not adequately address climate-related risks.

ESG factors are clearly an increasing focus for investors. Looking at BlackRock's CEO letter and letter to clients, for example, we note a number of initiatives to strengthen sustainability interests in its investment strategy. This includes integrating sustainability factors into investment decisions, portfolio construction and risk management; exiting investments that present a high sustainability-related risk, such as thermal coal producers; launching new investment products that ban fossil fuels or otherwise contain ESG characteristics and goals; and strengthening the commitment to sustainability and transparency in investment activities. Investors, also stimulated by new EU legislation such as the EU Action Plan Financing Sustainable Growth, are expected to increase their pressure on boards and to act on ESG-related risks and opportunities.

The Netherlands – developments in light of the Dutch Climate Act

In July 2019, the Dutch government and various stakeholders entered into the National Climate Agreement. In September 2019, the Climate Act entered into force, introducing several measures in various sectors to ensure a 49% cut in carbon emission by 2030. This was endorsed by the Dutch Supreme Court, which used the European Convention on Human Rights as a basis for ordering the Dutch government to take measures against climate change. The Climate Act provides a framework to develop policies in order to reach this goal. These measures will be implemented in several sectors of the economy in the coming years.

In April 2020, a number of political parties in the Dutch parliament (GroenLinks, D66, CU and CDA) jointly initiated and presented a new act requiring Dutch financial institutions to strive more actively to improve sustainability in order to meet the goals of the Paris Climate Agreement. The political parties proposed imposing a legal duty on financial institutions to report on sustainability-related risks per the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD). They encouraged the Dutch government to take action and support embedding this framework into IFRS standards and other reporting obligations. Transparency on climate policy, risks and metrics has increased over the years as a result of several new reporting standards; in 2019, 19 AEX and AMX (out of a total of 50) listed companies applied the specific climate-related TCFD recommendations.

Recently, the Dutch government announced plans to introduce the "BVm" (*maatschappelijke BV*) in Dutch corporate law. This will be a new private legal entity for social entrepreneurs active in addressing societal issues on energy, climate, healthcare, education, safety or labour force participation. The BVm legal framework details will be published before the end of 2020, when the draft bill is submitted for public online consultation. The government wants to put the final version of the bill to parliament before the March 2021 elections. The BVm option may offer new business and legal opportunities, especially as the Dutch government has announced that social enterprises will receive legal recognition and active government support in connection with legislation and regulations, knowledge sharing and funding.

Finally, following the announcement of the EU Green Deal in December 2019, Invest-NL was incorporated to provide financing to ESG initiatives.

EU – legislation continues to develop

Meanwhile, European lawmakers have been taking big steps towards a European legal framework. The European Council and the European Parliament have endorsed the common objective of a climate-neutral European Union with a fully circular economy by 2050. They introduced the EU Green Deal, based on which a Just Transition Mechanism is formulated to incentivise the private sector to invest millions of euro in environmentally sustainable businesses. The EU, through InvestEU and the EIB, is leveraging these investments and providing guarantees, so that in total EUR 1 trillion will be directed towards sustainable investments.

In addition, developments on its 2018 Action Plan: Financing Sustainable Growth continue at a rapid pace. This Action Plan follows three themes of disclosure and transparency requirements, classification of green products (Taxonomy) and climate benchmarks.

One of the most notable developments is the adoption and publication of the EU Taxonomy regulation, which entered into force on 12 July 2020. This regulation will introduce a classification system that identifies whether a specific economic activity is considered sustainable from an environmental perspective. By virtue of this taxonomy, the regulation aims to facilitate investments in genuinely sustainable activities and avoid "greenwashing". The EU Taxonomy will have an impact on listed companies since it will require them to report more in depth on selected environmentally sustainability topics in their management report. The technical screening criteria, according to which the specific sustainable activities will be categorised, will be based on a taxonomy set and monitored by the European Commission. In 2021 and 2022, the European Commission will work out and present these taxonomy details in stages.

The first company reports and investor disclosures under the EU Taxonomy guidelines are expected in early 2022. Over the summer, the EC consulted the EU Renewed Sustainable Finance Action Plan building the 2018 EU Action plan and providing a roadmap for directing private investments into sustainable projects.

The European Commission has also published a study on directors' duties and sustainable corporate governance of listed companies within the EU. The study concludes that:

- many companies still focus on the short-term benefits of shareholders, rather than on the long-term interests of their company;
- their board remuneration structures and board expertise pose challenges for sustainability;
- there is a lack of stakeholder input in their decision-making; and
- they have limited enforcement of the directors' duties when it comes to acting in the long-term interests of the company.

The European Commission has stressed that sustainability will need to be further embedded into the corporate governance framework of EU-listed companies.

Increasing supervisory focus on financial institutions

Additionally, supervisors play an increasing role in sustainability developments and thinking. For example, the Dutch Central Bank (DNB), has adopted a CSR Strategy and a Responsible Investment Charter, and it is taking an active role in nudging the financial sector towards sustainable finance by focusing on the physical, transitional and legal risks to their business.

The Dutch Authority for the Financial Markets (AFM) is clearly focusing on sustainable investing. In its newly introduced position paper on sustainability, the AFM makes clear that it sees the transition to a sustainable society/economy as one of the most important challenges of our time and will prioritise clear, correct and non-misleading information on sustainability and integrated reporting. By doing so, DNB and the AFM confirm that the financial sector is expected to play an important role in the transition towards a more sustainable economy. The AFM also offers investment firms and managers tools for implementing new legislation and regulations in the field of sustainability, and DNB has developed risk-assessment tools.