European Union Initiatives and Regulations on Sustainable Corporate Governance

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Abstract

The European Commission's guidelines for the period 2014-2019 provide for the European Union to focus on integrating the UN's sustainable development goals into economic, social, climate and industry competitiveness initiatives and policies. This tendency to focus on the financial profitability of the company in the short term and on the redistribution of a large part of the generated revenues to shareholders is widespread at EU level and can hinder the essential investments for the transition to sustainability, in productive facilities, innovation, modernization, training and re-qualification of employees. It can also contribute to income inequality, as in the short term it creates pressure to reduce wages, and employees often do not benefit similarly and proportionately from payments made to corporate management and shareholders. The goal of financial performance reduces the ability of companies to properly integrate sustainability considerations into their business strategies and decisions. This trend is manifested on two levels: on the one hand, companies do not properly identify and address climate change and other environmental, social, and human rights risks (including workers' rights, child labor, etc.) in operations and within their supply chains. On the other hand, companies fail to integrate potential new investment opportunities, or to ensure sustainability. These trends have been facilitated by weaknesses in corporate law and corporate governance codes, as they encourage directors' liability to shareholders and do not sufficiently cover the interests of other stakeholders. The study proposed for presentation aims to analyze the evolution of the European regulatory framework on sustainability, resilience and corporate social responsibility, as well as the stage of implementation of European directives in Romanian company and financial law with a focus on coding ESG standards ("environment, science, governance") and how to translate them from the soft law area to concrete, measurable obligations and how to sanction breaches of standards and obligations incumbent on Member States on the one hand and companies on the other.

Keywords: *Sustainable Development Goals (SDGs), Environment Social Governance (ESG), Corporate Governance, European Green Pact.*

JEL Classification: F21, K23

1. Sustainable development action plans

The adoption by the UN General Assembly of the Resolution containing the Political Declaration of the High-Level Policy Forum on Sustainable Development underlined the continued concern of Member States to promote the Sustainable Development Goals and the 2030 Agenda, of a universal nature whose objectives and targets are integrated and indivisible, "balancing the economic, social and environmental dimensions of sustainable development".

The Sustainable Development Goals, which are being pursued through the 2030

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Agenda, outline the action plan, an ambitious one that focuses on people, the planet, prosperity, peace and partnership.

The resolution adopted by the UN General Assembly includes multiple fronts on which states are invited to contribute: social (fighting against poverty, inequality; building peaceful, just and inclusive societies; protecting human rights, gender equality); environment (long-term protection of the planet and its natural resources) and governance (sustainable, inclusive and sustained economic growth, common prosperity). The three levels of action have been grouped under the acronym ESG ("environment, social, governance"), being included by the European Commission ("Commission") in its Policy Guidelines, platform - program, through which the European Union ("EU") aims to focus on the UN's sustainable development goals.

In its Communication on the European Green Pact, the Commission programmatically urges the transformation of the EU economy and society to achieve its ambitious climate goals, stating that "concern for sustainability should be further integrated into corporate governance, as many companies still focus too much on short-term financial performance and not enough on long-term development and sustainability[2]."

Concern for sustainability includes encouraging companies to make decisions based on environmental impact assessments (including climate and biodiversity) of the long-term social-human component, rather than on the basis of a short-term profitability calculation. The Sustainable Corporate Governance Initiative has been included in the results announced in the Circular Economy Action Plan, Biodiversity Strategies and is part of the Renewed Sustainable Growth Strategy. Studies carried out at the request of the European Commission indicate pressure from shareholders, especially those listed on regulated markets, for these companies to generate financial profitability in a short period of time and to redistribute most of their profits in the form of dividends to shareholders[3].

These shareholding policies work to the detriment of companies, affecting the long-term development, sustainability of the environment in which companies operate and indicate a pronounced downward trend in investment in production facilities, innovation, modernization, training and retraining of employees, all essential for the transition. to sustainability. Pressure to generate short-term financial performance reduces the ability of companies to properly integrate sustainability considerations into their business strategies and decisions. This approach has two consequences: one is that companies do not properly identify, treat and properly integrate the impact of climate change, other risks and effects on the environment, society and human rights (including workers' rights, child labor) into policies and actions. etc.) in their operations and supply chains. Many EU companies are sourcing from entities based in countries with more permissive social, human rights or environmental standards, and the identification and mitigation of related risks and impacts are low. The second situation is the case of

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[2] See European Commission, *Communication from the Commission to the European Parliament, the European Council, the Council, the European Economic and Social Committee and the Committee of the Regions. The European Ecological Pact*, available at https://eur-lex.europa.eu/resource.html?uri=cellar:b828d165-1c22-11ea-8c1f-01aa75ed71a1.0020.02/DOC_1&format=PDF (accessed 11.11.2021).

[3] See Ernst & Young - *Final Report - Study on Directors's Duties and Sustainable Corporate Governance, Justice and Consumer Affairs*, https://op.europa.eu/en/publication-detail/-/publication/e47928a2-d20b-11ea-adf7-01aa75ed71a1/language-en, (July 2020, accessed 11.11.2021).

companies that fail to integrate potential new opportunities for investment or to strengthen the ability to respond to changes in supply chains, market demand, climate, regulators, etc.

2. Study topics

The analysis carried out by the Justice and Consumer Affairs Directorate of the European Commission reveals seven main causes of the focus on the short-term benefits of shareholders to the detriment of the long-term interests of the Company:

a. Maximizing the return on invested capital meets the expectations of shareholders, as the first and last purpose of the contribution to the share capital of companies. The increase in the invested value comes both from the positive impact of the Company's operations on the cash-flow by changing the price of the listed shares, and from the financial result distributed in the form of dividends;

b. Investor pressure on the company's management for short-term returns is justified by competition between companies, as well as between professionals in the field of business administration, regarding the compression of time and the degree of multiplication of initial contributions of investors, so that they subscribes to share issues of companies with these attributes;

c. The lack of strategies focused on sustainability is both a cause and an effect of short-termism, being a setback of the competition for operational-financial performance, compressed in short intervals;

d. Remuneration practices favoring short-term results determine a clear preference for achieving objectives that maximize remuneration in direct proportion to the improvement of annual financial indicators;

e. The composition of the Board of Directors is relevant in terms of the presence of several categories of stakeholders in the group of people who establish the development strategy of the Company.

f. Corporate governance practices, ie the legal framework, related regulations and codes of conduct are not harmonized at European level, leaving to each state, respectively each sector of activity and companies, the freedom to implement in the form of mandatory obligation or principle. "Comply or explain", the appropriate standards of corporate governance.

3. Proposed solutions

The European Union's commitment to the Sustainable Development Goals and the 2030 Agenda and in particular the Long-Term Strategy for 2050[4], urges the European Commission to consider harmonizing the way companies set and prioritize their operational strategies, under the imperative of moving from short-term strategies to more responsible strategies with long-term impact. Accepting that the prevalence of shareholder interest will continue to influence the decision-making process of companies, being postponed investments in research and development, capital for the

[4] The EU aims to be climate-neutral by 2050 - a zero-emission greenhouse gas economy. This goal is at the heart of the Europe's Green Agreement and is in line with the EU's commitment to global action on climate change under the Paris Agreement.

acquisition or modernization of fixed assets necessary for the transition to creating sustainable values, the European Commission has a choice between several scenarios. Of these, two focus on raising awareness and disseminating good corporate governance practices through non-legislative action, either at European level or through national regulators. The third scenario is to set minimum rules to increase long-term value creation, while ensuring a level playing field through EU legislative interventions.

The magnitude of the impact of the companies' activities on the environment and society, as well as the deadlines short-term shareholders' detriment to the long-term interests of companies.

In the study carried out at the request of the European Commission, solutions to balance the immediate financial interests with those on sustainability converge in certain directions, with a number of key concerns. The inclusion of the principles of sustainability in the program documents is reflected in the proposals to amend or adopt new directives, which will stimulate shareholders and members of management to integrate and reconcile business plans with medium- and long-term strategic objectives (5-19 years), with the interests of employees, customers, treatment of risks to the environment, with the interest of society as a whole.

Another complementary level of action is to reflect the aspects of sustainability - risks, opportunities, impacts - within the trade strategy, so that the way of pursuing the actions necessary to correlate the trade strategy with the objectives of sustainable development and their deadlines are translated into good objectives. determined, with a scientific basis in terms of sustainability. It goes without saying that the alignment of strategies and the specification of well-founded objectives with precise achievement data cannot be achieved in the absence of adequate management structures and remuneration policies. A necessary step will be to co-opt in the boards of directors' people with experience in formulating and implementing sustainable development policies. This measure also involves building relationships with other stakeholders inside and outside companies.

The means of stimulating shareholders and managers to implement the package of measures on sustainable development of companies are equally different and similar to those that led to the development of short-term strategies. The proposals submitted by the study carried out at the request of the European Commission integrate the alignment of the financial performance criteria with those on sustainable development, the conditions for capitalizing the shares awarded as part of the remuneration of directors and other derivatives (allocation rights, stock option plan), including the prohibition of capitalization of shares for a certain period.

4. Current status

Since 2014, the transposition of Directive 2014/95/EU in the Member States of the European Union has begun[5], whose aim was to improve the presentation by companies of information on sustainability, such as social and environmental factors, in order to identify sustainability risks and increase investor and consumer confidence. In

[5] Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014 amending Directive 2013/34/EU as regards the submission of non-financial and diversity information by certain companies and large groups.

its resolution[6], the European Parliament has found that the presentation of non-financial information is indeed a key element in managing the transition to a sustainable global economy that combines long-term profitability with social justice and environmental protection. In this context, the presentation of non-financial information helps to measure, monitor and manage the performance of businesses and their impact on society.

Undertakings subject to non-financial reporting are required to draw up a non-financial statement containing information on at least environmental, social and personnel issues, respect for human rights, the fight against corruption and bribery. Such a statement should include a description of the policies, results and risks related to these issues and should be integrated into the management report of the undertaking concerned. The non-financial statement should also include information on the company's due diligence policies, as well as, where relevant and proportionate, its supply and subcontracting chains, to identify, prevent and reduce existing negative impacts, and potential.

Directive 2014/95/EU is not the first of its kind, who amends Directive 2013/34/EU[7], strengthening and completing the regulatory framework for non-financial reporting. In this respect, the instruments proposed by the amending act have helped to address two issues not yet covered: (1) inadequate transparency of non-financial information in the business environment and (2) insufficient diversity in the boards of directors of companies.

The lack of transparency in business reporting stems from truncated information, which focuses on positive performance, and camouflages significant negative aspects, especially those related to risk management, human rights and corruptions issues.

In Romania, the transposition of Directive 2014/95/EU was carried out through the Order of the Minister of Public Finance no. 1938/2016 which supplemented OMFP 1802/2014 for approving the Accounting Regulations on individual annual financial statements and consolidated annual financial statements, and by Order of the Minister of Public Finance 2844/2016 for the approval of the Accounting Regulations compliant with the International Financial Reporting Standards (IFRS), which apply to companies whose securities are listed on the Bucharest Stock Exchange[8]. Both legislative

[6] European Parliament resolution of 6 February 2013 on corporate social responsibility: responsible and transparent corporate behavior and sustainable growth (2012/2098 (INI)), OJ C 24, 22.1.2016, pp. 28–33.

[7] Directive 2013/34/EU on annual financial statements, consolidated financial statements and related reports of certain types of undertakings amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Directives 78/660/EEC and 83/349 Council Directive EEC Text with EEA relevance, OJ L 182, 29.6.2013, pp. 19–76.

[8] Prior to the changes introduced by OMFP no. 1938/2016 and by OMFP no. 2844/2016, the entities listed on the regulated market in Romania, namely the Bucharest Stock Exchange, by Regulation no. 1/2006, had the obligation to include in the annual report certain non-financial information, namely: "1.1.5. Assessing the aspects related to the employees/staff of the company a) Specifying the number and level of training of the employees of the company, as well as the degree of unionization of the labor force; b) The description of the relations between the manager and the employees, as well as of any conflicting elements that characterize these relations. 1.1.6. Assessment of the issues related to the impact of the issuer's core business on the environment A brief description of the impact of the issuer's core business activities on the environment, as well as any existing or expected litigation regarding breaches of environmental protection legislation." See for details Farcaș, Teodora Viorica, *Study on the implementation of Directive 95/2014 in Romania, the legislative perspective and the effective application*, „Revista Audit Financiar", year XVIII, Nr. 2 (158) / 2020, pp. 238-250.

frameworks have taken over from the Directive all non-financial reporting requirements, with regard to information on at least environmental, social and personnel issues, respect for human rights and the fight against corruption and bribery, including: "(1) a) a brief description of the entity's business model; b) a description of the policies adopted by the entity in relation to these matters, including the due diligence procedures applied; c) the results of the respective policies; d) the main risks related to these aspects arising from the entity's operations, including, where relevant and proportionate, its business relationships, products or services that could have a negative impact on those areas and how the entity manages those risks; e) key indicators of non-financial performance relevant to the specific activity of the entity. (2) If the entity does not implement policies regarding one or more of the aspects mentioned in par. (1), the non-financial statement provides a clear and reasoned explanation for this option."[9]

Through the study carried out at the request of the European Commission, the solutions to the identified problems concern proposals for the adoption of new directives or amendments to existing directives such as Directive 2017/1132 on certain aspects of company law[10] and Directive 2007/36 on the exercise of certain rights of shareholders in listed companies[11].

The European Commission has forwarded a proposal for a Directive to the Council and Parliament[12] with a view to updating the sustainability reporting framework.

The starting points for the proposal for a Directive are to address the information needs of users of sustainability information, namely investors, non-governmental organizations, the social partners and other stakeholders, on the one hand for the adoption of an investment decision and on the other. part to estimate the impact of these investments on people and the environment and to hold the entities at fault. The aim of the proposal for a directive is thus set out in order to improve sustainability reporting at the lowest possible cost, in order to make greater use of the potential of the European single market to contribute to the transition to a full economic and financial system. sustainable and inclusive, in line with the European Green Pact and the UN Sustainable Development Goals.

Through the proposal for a Directive, the European Commission outlines a more precise, substantially reporting system, the breaches of which are subject to a sanctioning regime, with well-defined responsibilities for those involved in auditing non-financial reports on sustainability.

The innovative approach lies first in empowering the European Commission to adopt sustainability reporting standards through delegated acts and specifying the requirements for their adoption. Firstly, the provisions point out the minimum quality criteria that the information reported in accordance with the standards should meet. Secondly, the provisions identify the topics that the standards should cover, and thirdly, they identify certain tools and initiatives that the Commission should take into account

[9] According to chap. 7, point 4921 of OMFP no. 1802/2014 and chap. 7, point 39 of OMFP no. 2844/2016.
[10] Directive 2017/1132 of the European Parliament and of the Council of 14 June 2017 on certain aspects of company law, OJ L 169, 30.6.2017, pp. 46–127.
[11] Directive 2007/36/EC of the European Parliament and of the Council of 11 July 2007 on the exercise of certain rights of shareholders in listed companies, OJ L 184, 14.7.2007, pp. 17–24.
[12] Proposal for a Directive of the European Parliament and of the Council amending Directive 2013/34 / EU, Directive 2004/109/EC, Directive 2006/43/EC and Regulation (EU) No. 1095/2010 537/2014 regarding the reporting by companies of information on sustainability.

in particular when determining the content of delegated acts, including certain acts. EU legislation, and initiatives to set global sustainability reporting standards. The Commission will adopt a first set of standards by 31 October 2022.

Another provision of the Directive aligns the collective responsibility of the members of a company's administrative, management and supervisory bodies with the revised sustainability reporting requirements. In particular, the provision contains the requirement for management, supervisory and supervisory bodies to ensure that the company concerned has reported in accordance with EU sustainability reporting standards and in the required digital format and removes the reference to the separate report currently allowed for reporting on durability. By several amending provisions, the Commission includes the requirement that the annual financial report include statements made by the financial reporting officers of the issuer that, to the best of their knowledge, the management report is prepared in accordance with sustainability reporting standards, as required. in Directive 2013/34/EU.

The references to the provisions of the Accounting Directive and Directive 2006/43/EC (Audit Directive) are updated as regards the requirement to audit financial statements in accordance with Article 34 (1) of the Accounting Directive and to specify whether the auditor or audit firm identified material misstatement in the MD&A as well as the requirement to publish the audit report, including the opinion on assurance on sustainability reporting. Finally, the references to the provisions of the Accounting Directive regarding the preparation of the management report are updated and amended to require sustainability reporting. These changes allow for the extension of sustainability reporting requirements to include listed companies in EU regulated markets, with the exception of micro-enterprises, including non-EU issuers. They also clarify the legal mandate of the competent national authorities to oversee sustainability reporting.

A consequence of extending the statutory auditor's obligations to publish the audit report, including the opinion on sustainability reporting, changes the role of this institution and requires the definition of the terms "statutory auditor" and "audit firm" to be taken into account to take into account their potential activity. ensure sustainability reporting, as appropriate. Therefore, new definitions on the terms "sustainability reporting" and "sustainability reporting" are proposed in the draft directive.

Assuming that a Member State lays down rules for the procedures for the authorization of statutory auditors in another Member State and decides that the applicant for authorization should be subject to an aptitude test, that test shall at the same time cover the statutory auditor's adequate knowledge of to the laws and regulations of the host Member State which are relevant for ensuring sustainability reporting.

An important role is played by the Audit Committee of the Management Board, which is responsible for informing the audited entity's management or oversight body of the results of the sustainability reporting process, how it has contributed to the integrity of the sustainability reporting process. was the role played in this process. Additional tasks are incumbent on the audit committee in monitoring the sustainability reporting process, in the process carried out by the company to identify the information reported in accordance with the relevant reporting standards and in presenting recommendations or proposals to ensure its integrity.

The audit committee shall monitor the effectiveness of the systems used by the company for internal quality control and risk management and, where appropriate, the

effectiveness of the internal audit, in terms of sustainability reporting, without compromising the company's independence. Last but not least, the audit committee must monitor the provision of annual and consolidated sustainability reporting and review and monitor the independence of statutory auditors or audit firms.

5. Limitations and barriers

From the conclusions of the study carried out at the request of the European Commission to the proposal for a Directive on the reporting by companies of information on sustainability, the intentions of the initiator regarding the extension of the reporting content, the accountability of the governing bodies new responsibilities for financial auditors in issuing advice on ensuring sustainability reporting.

The first limitation of regulation in the form submitted to Parliament and the Council is the emphasis on form and content, less on the quality of the information included in the directors' report on sustainability. It is conclusive to specify a reference date for the adoption of delegated acts by which the Commission is to specify the information to be provided by undertakings and at least the information corresponding to the needs of financial market participants subject to the disclosure requirements set out in Regulation (EU) 2019/2088. Future applicable reporting standards are also relevant as they will require that the information to be reported be intelligible, relevant, representative, verifiable and comparable and be faithfully represented. No less important is the inclusion of information that companies need to present about environmental, social and governance factors. The categorization of information will require reporting entities to consider the impact of the policies adopted and the activities carried out on these factors in the succession of risk identification and treatment and in the consideration of potential residual risks. On the other hand, the effect of these measures is not easy to quantify, at least for a few arguments. Thus, the factors for changing the way companies operate are the management bodies, respectively the shareholders and the persons mandated to manage the companies. Although the reference study commissioned by the European Commission suggested that a proposal for a directive be revised which would have revised the obligations of directors, shareholders' rights, the composition of boards of directors, the establishment of stakeholder consultation, cooperation and co-operation mechanisms, the Commission has not yet published There are no indications that such rules will be adopted in the near future.

For shareholders and diligent management bodies in implementing the measures necessary to meet the sustainability criteria, such legislative initiatives would not be important. But, as the Commission-ordered study realistically states, the attraction to short-term gains will not be converted by simply imposing reporting obligations, no matter how precise and complex they may be.

Another element to consider when changing the regulatory framework for sustainability reporting is the deadlines for transposing directives into the national law of the Member States. As in other cases, the timetable for transposing the directives shall be at least two years, plus the time required for the adoption of secondary legislation in the Member States, the review of practices, operations which will maintain the status quo for a period equivalent to that required for the adoption of a directive. amending Directive 2014/95/EU, i.e. at least eight years, ie at the end of the 2030 deadline, the

intermediate stage of the European Union's commitment to reduce greenhouse gas emissions by up to 55 percent[13].

6. Conclusions

The European Commission has undertaken ambitious plans, both in the political agenda and in subsequent communications, to support the implementation of the 17 UN Sustainable Development Goals and the operationalization of the action plan needed to implement the 2030 Agenda.

This approach has led the European Commission to look at harmonizing the way companies set and prioritize their operational strategies, under the imperative of shifting from short-term strategies to more responsible strategies with long-term effects. Along with other European Commission policy documents, the proposal for a Directive on the reporting by companies of sustainability information is a necessary step towards harmonizing the content of the reporting, the way in which management is accountable for this, including assigning new tasks to financial auditors in issuing the opinion on ensuring sustainability reporting.

In the current pandemic context, the timetable for the adoption, transposition and implementation of this directive is a race against the clock to achieve the goals set by the 2030 Agenda and the legislative package to reduce greenhouse gas emissions, with the main aim of creating a sustainable development context.

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