Ambassador Ivan Rogers,
Ambassador Extraordinary and Plenipotentiary Permanent Representative (Coreper II)
Permanent Representation of the United Kingdom
Avenue d'Auderghem 10/Oudergemslaan 10
1040 Bruxelles/Brussel
Belgique

11th November 2015

Re: Retaining the environmental and social risk management requirements within the forthcoming EU trialogues under the Shareholders Rights Directive

Your Excellency,

We, the undersigned civil society organisations, are writing to you to highlight the importance of retaining the environmental and social risk management amendments proposed by the European Parliament, within the forthcoming EU trialogues on the Shareholders Rights Directive.

The amendments proposed by the European Parliament will give investors and asset managers more powers and obligations to scrutinise and hold to account investee companies, including on how environmental, social and corporate governance risks are considered. Given that Europe's asset management industry controls €17 trillion of assets[1] if this Directive succeeds in encouraging more responsible, engaged ownership behaviour, the effects would be far reaching.

European private investors – including banks, equity funds and pension funds – are increasingly global agents. At the start of 2015, the top EU-based financial institutions (including banks, institutional investors and alternative investment funds) had provided nearly US$18 billion in outstanding loans and recent underwriting services to foreign agriculture companies based in developing countries. EU financial institutions are also major holders of shares in stock-market listed agricultural companies based in developing countries; in early 2015 the top 20 institutional investors held US$2.8 billion.

But such expansion comes with risks. Friends of the Earth Europe, Global Witness and others have highlighted the role of European financial institutions to companies engaged in land grabbing, environmental degradation and deforestation.[2] ESG concerns are not just ethical however, there are substantial financial material risks for corporations, and subsequently their investors, of not taking adequate consideration of the ESG impacts of their operations. The emissions scandal involving automobile manufacturer VW demonstrates this well. In addition

[1] European Commission Green Paper, 'Building a capital markets Union', 2015, available at http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52015DC0063
[2] For examples of how EU-based investors are financially involved in projects overseas causing land grabbing and deforestation, please see the reports by Global Witness Rubber Barons (2013) and the New Snake Oil (2015).

to the negative implications for the environment and people's health as a result of air pollution, the implications for investors in VW have also been extremely serious; for the first time in 15 years VW's quarterly accounts have reported a loss, of €3.5 billion, according to media sources.[3] A coalition of investors with £625 billion assets under management has now written to 11 other automobile manufacturers asking for more clarity on their stance on these issues.[4] The VW case demonstrates the financial costs for companies and their shareholders, of not adequately understanding or reporting on ESG risks; risks which may have been avoided had the proposed investor engagement policy requirements of the Shareholder Rights Directive been in place.

Consideration of ESG factors is, therefore, essential for good risk management but also an opportunity for investors and companies to generate positive investment returns. This is demonstrated by a 2012 meta-analysis by Deutsche Bank Climate Change Advisors of more than 100 academic studies, which found that incorporating environmental, social and governance data in investment analysis is *"correlated with superior risk-adjusted returns at a securities level"*.[5] Despite a growing body of evidence showing the value to investors of adopting strategies that include consideration of ESG factors, many investors are still slow to adopt such strategies. As such it is appropriate for the revised Shareholder Rights Directive to expedite and mandate consideration of ESG factors.

The amendments proposed by the European Parliament relating to improved scrutiny of environmental, social and governance risks by investors of their investee companies are important in the following ways:

- Article 3f(1)(b) requires that institutional investors or asset managers prepare an engagement policy which *"shall determine how institutional investors and asset managers ... monitor investee companies, including on their non-financial performance, and reduction of social and environmental risks ... and to conduct dialogue and cooperate with other stakeholders of the investee companies"*
    - ➢ This expansion of the definition of the engagement policy requires that social and environmental risks are assessed and reduced, in cooperation with stakeholders, which would help investors ensure the companies they invest in are not undertaking projects causing land grabbing or deforestation

These amendments are supported by subsequent amendments to the Directive

- Article 2jb provides a wider definition of "stakeholder" inclusive of any individual, organisation or local community that is affected or otherwise has an interest in the operation and performance of a company

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[3] As reported in http://www.theguardian.com/business/2015/oct/30/vw-scandal-the-winners-and-losers-from-carmakers-to-car-owners

[4] For further information, please see: http://shareaction.org/concerned-investors-over-%C2%A3625-billion-under-management-call-greater-clarity-emissions-lobbying-autom

[5] Further information is available here: https://institutional.deutscheawm.com/content/_media/Sustainable_Investing_2012.pdf

- Such a definition incentivises companies to operate responsibly with regard to local communities and invest in attaining a social license to operate
- Article 2h provides an expanded definition of 'shareholder engagement' wherein it means the monitoring by a shareholder alone or together with other shareholders, of companies on relevant matters including strategy, financial and non-financial performance, risk, capital structure, human resources, social and environmental impact and corporate governance
- Article 3f(3) requires asset managers to publicly disclosure how their investment strategy is being implemented

However, the proposed implementation of this investor engagement policy through a "comply or explain" mechanism (as proposed by the Commission, Council and Parliament) could weaken the above measures, unless further detail is inserted during the trialogue European negotiations which ensure that sanctions will be applied, should reporting on this provision be neither complied with, nor explained, by investors.

The retention of the Parliament's explicit inclusion of environmental and social risks in investor engagement policies in the final negotiated Directive would ensure Europe is aligned with its existing corporate governance and human rights commitments:

- Directive 2014/95/EU (non-financial reporting directive), the 2011 Single market Act – Working Together for Growth, and drawing upon the Renewed EU Strategy 2011-2014 for Corporate Social Responsibility and the European Convention on Human Rights;
- The UN Guiding Principles for Business and Human Rights, the Voluntary Guidelines on the Governance of Tenure of Land, Forests and Fisheries in the context of National Food Security, the International Labour Organization's Tripartite Declaration of principles concerning multinational enterprises, and the UN declaration on the rights of Indigenous Peoples.

These amendments would bring Europe in line with the OECD's July 2014 recognition of the "direct link" between the financial sector and the adverse impacts of the projects they invest and the OECD's recommendation that: *"Financial institutions, like any other MNEs, should thus avoid causing or contributing to adverse impacts, and seek to prevent or mitigate those impacts when their operations, products and services can be directly linked to them by a business relationship"*.[6]

The revision of this Directive is a key opportunity to improve transparency and accountability in Europe's investment system and tackle corporate governance failings in the companies that European investors own, around the world.

[6] OECD (2014) Working Party on Responsible Business Conduct: The terminology on "directly linked" in the context of the financial sector, note by the Secretariat. 19 July 2014, DAF/INV/RBC(2014)1/REV1

We therefore encourage you to support the amendments to introduce non-financial social, environmental and governance considerations into investor engagement policies, and public reporting requirements.

Finally, our organisations also recognise and are in support of the amendments proposed by the European Parliament relating to tax transparency, on the basis of country-by-country-reporting.

Yours sincerely,

Action Aid
Attac-Ireland
Both ENDS
CAFOD
Client Earth
CORE
Centre national de coopeération au développement CNCD-11.11.11
Eurodad
European Coalition for Corporate Justice
FERN
Friends of the Earth England, Wales and Northern Ireland
Friends of the Earth Europe
Friends of the Earth Netherlands
Global Witness
Just Democracy UK
Kairos Europa
London Mining Network
Oxfam GB
Progressio
Rainforest Action Network
ShareAction
SOMO
TREE AID
UK Food Group
WWF UK