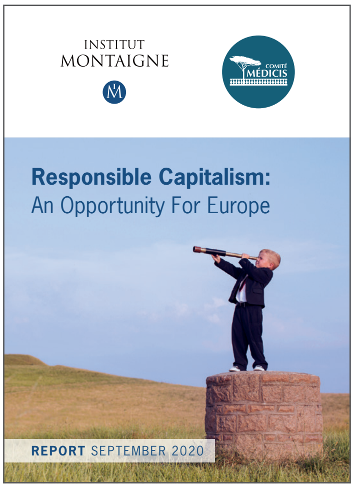
INSTITUT MONTAIGNE

COMITÉ MÉDICIS

Executive Summary



In view of contemporary geopolitical developments aggravated by the health crisis, as well as the economic and environmental emergency, Europe must seize the opportunity to implement a responsible capitalism. This new form of capitalism must act as the pillar of Europe's refoundation, in accordance with its original philosophy: "the social market economy".

This report presents a set of measures designed to ensure growth and independence for European businesses and nations by creating the architecture of a capitalism that mobilizes the savings of Europeans and directs them towards "responsible" European businesses.

These measures seem particularly appropriate at a time when savings are plentiful and activity must be revived. Nonetheless, environmental and social responsibility must be taken into account as prosperity is inconceivable without them. These measures are intended to help European capitalism evolve, to enable it to recover an identity that has been blurred by globalization and that reflects its demographic, economic, cultural and social characteristics.

Encouraging long-term investment in Europe at a time when short-term capitalism is prevailing

First of all, these actions consist in modernizing prudential and accounting rules, geared to globalization and inspired by an American financial capitalism focused on short-term visions and returns. European savings must be mobilized and invested for the long term.

We then propose the introduction of measures that correspond to the values and characteristics of the European economy, making it possible to responsibly direct the flow of savings to companies:
- Using the pension funding needs of an ageing population to create a sovereign European pension fund investing in the development of European infrastructures and companies;
- Setting up a real European capital market correcting the current imbalances;
- Creating mechanisms for local investment;
- Developing employee profit-sharing;
- Ensuring that foreign direct investments respect European values.

Taking back control over accounting information - financial and extra-financial - to align it with European values

This means giving European capitalism a framework of standards in line with European values. In the field of financial information, this means taking back control over accounting standardization, which is currently delegated to an independent body (IASB) that has put forward a short-sighted view of the financial representation of companies. With regard to extra-financial information, i.e. information describing the company's relationship with society and the environment, it means building a European normative framework in line with European challenges and values.

Otherwise, European companies will be forced to accept not only the American financial conceptual framework but also American social and societal values.

Creating a common legal framework to support responsible European businesses

In the field of corporate law, European capitalism must stand out as the one putting the "purpose" at its center. It also needs to ensure that its corporate governance tenets are those of responsible capitalism.

Thus, this report proposes a systematic plan for the establishment of a responsible European capitalism capable of revitalizing European economies and ensuring that its companies have access to the capital they need to succeed. In other words, rather than mistrusting capital and finance, we propose that they be the drivers of a European renaissance and a new pact between businesses, society and governments, putting the abundant savings of Europeans at the service of responsible capitalism.

Recommendations

Recommendation no.1

To finance responsible growth in Europe, we must allocate European financial resources to long-term investments:
- Used to meet the needs for responsible infrastructure and to reduce inequalities between European countries;
- Used for investments enabling the ecological transition;
- That encourage private investment in responsible infrastructures which are drivers of growth and local development;
- Accomplished through investment plans for strategic European infrastructures with concession schemes adapted to the requirements of responsible capitalism.

Recommendation no.2

Using primarily the savings of European households and companies to finance responsible European companies, by exploiting the coincidence of the environmental and social transitions.

This will involve:

- Reforming the prudential rules of insurance companies;
- Benefiting from the aging population to steer pension savings towards responsible assets;
- Setting up an extensive European pension system based on a proportion of existing savings invested in the environmental transformation;
- Give responsible investments a strategic aspect that could limit, prevent and control extra-European equity investments.

Recommendation no.3

Investigating the creation of a European pension fund, collecting a portion of household savings and complementing national pension funding solutions. Such a mechanism would allow for Europe to adopt a unified approach to resolving issues of old age. This sovereign fund would be invested in the long-term in responsible companies, with governance rules inspired by German and Swedish funds (joint or mutualist management, priority given to responsible investment, civil society representatives).

Such a fund would enable a portion of the long-term savings of households to be invested in responsible companies.
A system like this would gradually complement life insurance schemes in countries where such schemes are massively used by savers for pension purposes.

Recommendation no.4

Taking into account the lessons of the 2020 crisis, adapting the prudential standards applicable to financial activities (Solvency II, Basel III) to encourage long-term investment in responsible capitalism.

a. Solvency II must be reformed to permit more responsible investments in:
  - **a.** Large responsible European companies, thus guaranteeing their resilience to enable resistance against international competition;
  - **b.** Small and medium-sized companies that produce on a local scale;
  - **c.** Long-term investments, by waiving the mark-to-market rule.

b. The Basel Accord resulted in a substantial increase in the capital requirement of European banks, which, unlike American banks, record the majority of the financing of the economy on their balance sheets. In addition, provisioning mechanisms have a procyclical nature. This framework can weigh upon the financing of the economy, even though the ECB relaxed the prudential requirements for company capital during the last period. For many, these agreements are strongly guided by American realities, where the banks are relatively uninvolved in financing the economy and do not record credits on their balance sheet, but sell them on financial markets via securitization. The result in Europe is a constant increase in the company capital of banks and an increase in the cost of credit.

Recommendation no.5

Developing the Capital Markets Union for investment in responsible companies at European level and, within this framework, harmonizing the tax rules applicable to the various investment instruments in Europe to determine a European flat tax on financial assets and harmonized bankruptcy laws as quickly as possible.
Transposing the "Restructuring and Insolvency" directive as uniformly as possible in each of the Member States.

Recommendation no.6

Creating private equity funds allowing for local investment and that direct the financial savings of one region to the companies of this same region so as to enable the development of local employment.

Recommendation no.7

Increasing employee shareholding, notably by harmonizing the rules concerning profit-sharing and investment incentive schemes[1].

Recommendation no.8

Defining the terms of a social taxonomy to complement the ecological taxonomy, taking into account health and social concerns.

Recommendation no.9

Taking back control over the principles that govern European accounting standards within IASB and re-defining a European accounting framework.

To that end:

- The EU must apply pressure, whenever necessary, on IASB to make IFRS norms more supportive of the Union's values and those of its Member States;
- The EU must have the power to approve accounting standards *ex ante*, before they are imposed by IASB;
- The EU must finance a study to be carried out by European experts appointed by the European Commission to define a European accounting framework.

Recommendation no.10

Revising the 2014 extra-financial reporting directive to leave the mark of a European responsible capitalism.

1 As we already proposed in our January 2018 report, *"ETI : taille intermédiaire, gros potentiel"* (ETIs: intermediate size enterprises with huge potential).

This single framework could be a compromise of several current standards. It must enable stakeholders to understand the extra-financial performance of a company easily. Two main ideas should be made clear:

- A responsible company is not one that is satisfied with protecting itself against certain risks, but one that contributes to protect society and its ecosystem;
- A responsible company is one that, beyond having an ambitious ESG policy, helps to create, protect and promote its intangible assets. These notably include human capital (employee training, the preservation of their employability, the company's educational responsibility, etc.) and innovation capital.

Europe must seize this opportunity to set up a normalized framework for extra-financial information that is specific to Europe and represents its values.

Recommendation no.11

Identifying the key ESG criteria that correspond to the fundamental values of the EU, before selecting indicators, i.e.:

- Solidarity;
- Individual freedom;
- Regional and cultural diversity;
- Contribution to well-being (employment, socialization, availability of essential services, etc.);
- Preservation of the climate and biodiversity;
- Cooperation between companies, societies and States centered on fundamental common goods (this cooperation can be measured in terms of companies' "purposes" which should be encouraged);
- Role of unions;
- Innovation;
- Contribution to transitions;
- Fairness and compromise in the solutions proposed.

Based on these cardinal values, the European Union must create and finance a working group to define these values, and propose a set of values to be translated into a number of ESG indicators/information categories by the end of the year.

Recommendation no.12

Making ESG requirements based on a green and social taxonomy a condition for all national or European financial aid.

It is essential that public resources are reserved for responsible players. This orientation has already been more or less confirmed for climate-related issues, for example in the European Green Deal. This must be completed by social issues. The group created in May 2020 by the European Commission on the European Green Deal, presided by Thomas Buberl, could define the list of these conditions and their scope (over and above the simple green condition). The recovery plan proposed by the European Commission and adopted by the Council in July 2020 also makes explicit reference to social imperatives and the notion of economic and social resilience.

Recommendation no.13

Reforming EFRAG so that it includes a European vision of ESG, in compliance with the challenges and values of the European Union.

The scope of the European Financial Reporting Advisory Group (EFRAG), founded in 2001 to express the European voice in the drawing up of international accounting standards and to advise the European Commission on the adoption and implementation of said standards, could be extended to include extra-financial aspects. A technical initiative in this direction was launched in 2019 for climate-related reporting and the proposals of TCFD, as part of the European Lab Project Task Force on Climate Related Reporting, created by EFRAG for this purpose. The mission requested from the EFRAG Board President by the Executive Vice-President of the Commission, Valdis Dombrovskis, in July 2020, clarifies the need to reflect on a potential European extra-financial reference framework and a reform of EFRAG to enable it to assume responsibility in this area over time, if necessary. In order to be effective, these new mandates should be accompanied by a reinforcement of the competencies of EFRAG members concerning ESG criteria and a more political and less technical, more offensive and less passive positioning of the institution. This politicization of EFRAG's role will probably imply modification of the composition of its Board and its Technical Expert Group. Its general assembly meeting could also be completed by including institutions and/or representatives related to ESG topics. Finally, it should be possible for EFRAG to be heard by the Council of the EU and by the European Parliament.

Recommendation no.14

Drawing up a code of conduct for extra-financial rating agencies. A similar approach should also be implemented for proxy advisers.

The supervision of extra-financial rating agencies and proxies, based on a code of conduct to be drawn up, could be taken on by the European authorities that currently regulate the financial markets and players.

This code of conduct could be based on the following criteria:

- Transparency;
- Permanence;
- Qualification of analysts;
- Geographic distribution of analysts and proximity to issuers;
- Prevention of conflicts of interest;
- Availability of primary data;
- Protection of information provided by issuers;
- Etc.

Since this concerns contributors with an impact on market operation and investor protection, it is logical that extra-financial agencies and proxies be regulated by the European Securities and Markets Authority (ESMA).

Furthermore, to ensure true international influence, which is a necessary element of their efficiency, the fundamental ESG values defended by Europe and the debates surrounding the evolution of ESG criteria should be shared with other international institutions. The Impact Management Project group and OECD are suitable candidates, since they already combine private and public institutions, with both financial and extra-financial expertise.

It would also be advisable to encourage the development of an independent European voting recommendation player, whose critical size must be large enough to represent an alternative to the current duopoly.

Recommendation no.15

Stipulating that a European company must be managed according to its corporate interest in consideration of the social and environmental issues related to its activities, and encouraging all European companies to adopt a “purpose”, a key element of their image in society and of the definition of their commitment to common good.

Recommendation no.16

Enabling responsible European companies to have long-term European shareholdings. This brings us back to the mobilization of European savings and therefore shareholders that believe in the European values and influence management on the basis of common values.

This means:

- That the company must be able to finance itself through innovative debt instruments whose remuneration could depend upon its social or societal impact, like green bonds or green loans;
- Making sure that the prudential requirements concerning company capital applicable to banks and insurance companies are adapted to allow these institutions to finance responsible companies (the responsibility criterion must be taken into account in the same way as the durability criterion);
- Promoting shareholder foundations and making sure that their legal and fiscal frameworks are harmonized;
- Ensuring that company stocks and shares are not subject to forced heirship.

Recommendation no.17

Establishing European guidelines subject to the same requirements, in the areas of corporate governance, remuneration of directors, tax policy and due diligence.