

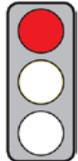
REPORTING REQUIREMENTS ON “DIVERSITY” AND “NON-FINANCIAL RISKS”

cepPolicyBrief No. 2013-36 of 09 September 2013

KEY ISSUES

Objective of the Directive: The Commission wants large and medium-sized companies to fulfill reporting requirements on non-financial risks and on „diversity policies“ for the appointment to management and supervisory bodies.

Parties affected: Companies and shareholders.



Pros: –

Cons: (1) The proposal is – preliminary – doomed to fail, since the Directives to be amended have been revoked.

(2) The reporting requirements for the diversity policies will force companies to include variables in their personnel policies that are completely insignificant to the company's success.

CONTENT

Title

Proposal COM(2013) 207 of 16 April 2013 for a **Directive** of the European Parliament and of the Council amending Council Directives 78/660/EEC and 83/349/EEC as regards **disclosure of non-financial and diversity information** by certain **large companies** and groups.

Brief Summary

Note: All articles are references to the Directives 78/660/EEC and 83/349/EEC that are to be amended.

► Background and objective

- The Commission finds “market and regulatory failure” (p. 4) in that
 - only 2.500 of 42.000 large companies are disclosing “non-financial information” – notably information on the handling of their social responsibility and that
 - the quality of the disclosed information is inadequate.
- The Commission wants to expand Corporate Social Responsibilities (CSR) and therefore commit companies to greater transparency. Companies should be subject to extended reporting requirements for
 - “non-financial risks and opportunities” (p. 2), notably on environmental, employee-related and social matters and
 - its “diversity policies” (p. 3) which are to the Commission, the composition of boards to aspects of age, gender, geographical origin and education.
- This shall be done by amendments to
 - the Fourth Directive on the annual accounts of certain types of companies (Directive 78/660/EEC) and
 - the Seventh Directive on consolidated accounts (Directive 83/349/EEC).

► Amendment to the annual reports of companies about non-financial information

- Reporting requirements for companies with share capital include an annual account and an annual report.
 - The annual accounts must give a “true and fair view of the company's assets, liabilities, financial position and profit or loss” (Art. 2 (3) Directive 78/660/EEC).
 - The report must be true and consistent with the size and complexity of the business (amended Art. 46 (1) (a) Directive 78/660/EEC).
- In future, companies with share capital (e.g. in Germany: AG, KGaA, GmbH) with more than 500 employees and
 - a balance sheet total of more than 20 million Euro or
 - a net turnover of more than 40 million Euro,
 must include a statement of non-financial information in its report (amended Art. 46 (1) (b) Directive 78/660/EEC).
- Where a parent undertaking does not exceed the given size, but its subsidiary, the parent is still liable to the disclosure of non-financial information. Only, if the parent undertaking prepares a consolidated annual report that refers to the whole group of undertakings, the parent undertaking is exempt from preparing its own annual report (amended Art. 36 (1) sub (3) Directive 83/349/EEC).

- The report must include a non-financial statement that must at least contain information on (amended Art. 46 (1) lit b Directive 78/660/EEC):
 - environmental, social and employee matters,
 - respect for human rights and
 - anti-corruption and bribery matters.
 - Information on these matters include,
 - which policies are pursued by the company,
 - the results of these policies,
 - the risks the company faces and
 - how the company manages those risks.
 - Undertakings and parent undertakings that do not pursue policies in relation to a matter must provide an explanation for not doing so in their annual report (amended Art. 46 (1) lit b Directive 78/660/EEC and amended Art. 36 (1) sub (4) Directive 83/349/EEC).
 - The Commission estimates the cost per company, resulting from the disclosure requirements, to be between 600 and 4.000 EUR. [SEC(2013) 128, p. 8].
- **Amendments to the annual reports about the composition of management and supervisory bodies**
- The Commission finds that “insufficient diversity” (p. 3) in management and supervisory bodies has a negative impact on the performance of companies, because it leads to “narrow group think” (p. 5) that deters innovation.
 - The Commission interprets the “insufficient diversity” to have resulted from a “market failure”.
 - For this reason, the Commission wants to enlarge the “corporate governance statement” that already goes into the annual report of publicly listed companies.
 - In future, publicly listed companies must include a description of the company’s policies for the composition of its management and supervisory bodies (diversity policies) in its annual reports. The report must include information on (amended Art. 46a (1) lit g Directive 78/660/EEC)
 - age,
 - gender,
 - geographical diversity,
 - educational and professional background and
 - on the objectives, the implementation and the results of the diversity policy.
 - This requirement does not apply to companies that do not exceed the limits of two of the three following criteria (amended Art. 46a (4) Directive 78/660/EEC in conjunction old Art. 27 Directive 78/660/EEC):
 - a balance sheet total of less than 17,5 million Euro,
 - a net turnover of less than 35 million Euro and
 - less than 250 employees.
 - The Commission estimates the cost per company, resulting from these disclosure requirements, to be between 600 and 1.000 EUR [SEC(2013) 128, p. 8].

Changes to the Status Quo

- Up to now, non-financial performance indicators were included in the annual report only where deemed “appropriate”. In the future, such indicators always have to be included in the report.
- That non-financial information must include information on environmental, social and employee matters, the respect of human rights and anti-corruption measures is new.
- Up to now, annual reports had to include information on the governance code to which the company is subject or provide an explanation on why the company chose not to operate under such code. Information on the diversity policy are not mandated (old Art. 46a (1) Directive 78/660/EEC).

Statement on Subsidiarity by the Commission

The Commission finds that national legislation on disclosure requirements that go beyond the content of the Directives it amends are significantly diverse and lead “to difficulties to benchmark companies” (p. 6). Only action on EU level may resolve this problem.

Policy Context

The Commission has already criticised the different national requirement for CSR in its Communication “A renewed EU strategy 2011-2014 for Corporate Social Responsibility” [COM(2011) 681; s. [cepPolicyBrief](#)] and has announced this proposal for a Directive in its Communication “Action Plan: European company law and corporate governance” [COM(2012)740; s. [cepPolicyBrief](#)]. The legislative proposal of the Commission from November 2013 on the introduction of a gender quota (“gender quota for women”) [COM(2012)614; s. [cepPolicyBrief](#)] is complementary to the proposed reporting requirements on the diversity policies of companies.

Legislative Procedure

16 April 2013	Adoption by the Commission
Open	Adoption by the European Parliament and the Council, publication in the Official Journal of the European Union, entry into force

Options for Influencing the Political Process

Leading Directorate General:	DG Internal Market and Services (leading)
Committee of the European Parliament:	Legal Affairs (leading), rapporteur Raffaele Baldassarre (EVP-Group, IT); Economic Affairs ; Employment; Environment; Industry; Internal Market; Gender Equality
Leading German Federal Ministry:	Economic Affairs (leading)
Committee of the German Bundestag:	Labour (leading); Economic Affairs; Family Affairs
Decision mode in the Council:	Qualified majority (rejection by 93 out of 352 votes; Germany: 29 votes)

Formalities

Legal competence:	Art. 114 TFEU (internal market)
Form of legislative competence:	Shared competence (Art. 4 (2) TFEU)
Legislative procedure:	Art. 294 TFEU (ordinary legislative procedure)

ASSESSMENT

The Commission's proposal is – preliminary – doomed to fail on formal grounds. **Since the Directives it amends (78/660/EEC, 83/349/EEC) have been revoked** through the Directive on annual financial statements (2013/34/EU) **on July 16th, 2013**. However, it can be assumed that the Commission will adapt its plans on reporting requirement to formal and legal matters and propose again. The following assessment was made against this background.

Economic Impact Assessment

Ordoliberal Assessment

The original principle, that Corporate Social Responsibility (CSR) is to be based on voluntariness, will be further impaired by the Commission's proposal. The Commission choose to take this path in its Communication "A renewed EU strategy 2011-2014 for Corporate Social Responsibility" [COM(2011) 681; s. [cepPolicyBrief](#)] where it redefined the term of CSR and thereby neglected the word "voluntary". That 2.500 large companies in the EU already disclose voluntary non-financial information speaks for a voluntary approach. A breach of goals following current regulation – to only disclose "appropriate" non-financial information - has not been proven by the Commission.

The Commission's concern to make more and better information on non-financial risks accessible is comprehensible in principle. However, the proposed reporting requirements will come to nothing. To begin with, the concerns must be limited to investors, because as opposed to consumers or civil societies, only investors take losses from company values in distress following the occurrence of a non-financial risk. Company values would however not respond to any risk-taking behaviour, but even more when prudential and criminal sanctions are imminent. If and insofar as a company has taken risks, it will not, despite legal obligation, disclose information about its behaviour. A disclosure would appear as self-incrimination.

With its proposal for diversity policies, the Commission takes the same wrong path as it did with the proposal for a gender quota for women [(COM) 614; s. [cepPolicyBrief](#)] and like then, follows purely ideological goals. Its arguments serve merely as an excuse. The argument that more diverse management and supervisory bodies would lead to more efficient corporate governance and to a better competitiveness seems like a bold claim against the lack of good empirical data. Moreover, the "insufficient diversity" in boards is in no case a market failure, but rather the result of a market allocation. Competition and the pressure for profits force the selection of the most fit management personnel – independent of age, gender as well as geographical and social background.

Forcing companies to disclose information on its diversity policies will have them, de facto, bow to the ideology of the Commission. **The reporting requirement for the company-specific diversity policies will thus force companies to include variables in their personnel policies that are completely insignificant to the Company's success.** Such political infringement of the freedom to conduct a business is mistaken in a free market order.

Impact in Efficiency and Individual Freedom of Choice

To make the disclosure of non-financial information binding leads to efficiency losses: Companies have to exhaust resources to meet the requirements that it would have otherwise used for its actual object – the production of goods and services. Non-financial information may be of interest to investors but only as long as they are relevant to the understanding of the course, the results and the situation of business. The existing requirements on the disclosure of non-financial information are therefore quite sufficient and do not put undue bur-

dens on companies. In this light, **the Commissions concern to require the disclosure of non-financial information** is unnecessary. It **leads to higher administrative burdens and costs for businesses.**

The estimates of the costs of disclosure are unrealistically low. Firstly, not all necessary information is directly available and has thus to be gathered and processed. Secondly, non-financial information as part of the annual report is subject to audits by external auditors and causes additional costs. In contrast, the benefits that correspond to these costs are ambiguous. The lapidary argument by the Commission that disclosure leads to more competitiveness and a better management is not empirically proven.

Likewise, to require disclosing the policies on diversity leads to inefficiencies, because it will take companies to include variables in its personnel policies for management and supervisory bodies that are completely insignificant to business operations.

Impact on Growth and Employment

When boards of companies are filled with personnel that have few qualifications due to politically motivated criteria for composition, erroneous trends impend not only on the level of the firm but for the economy as a whole that will go with losses in growth and employment. The wrong appointment of supervisory and management bodies of German Landesbanken then, that was too politically motivated, illustrates this.

Impact on Europe as a Business Location

In principle, additional requirements that drive up production cost as with the disclosure of non-financial information and information on the diversity policies of enterprises, without bringing about efficiency gains, have a negative impact on Europe as a business location.

Legal Assessment

Competence

The EU may enact safeguards for the protection of the interest of investors or third parties (Art. 50 Abs. (2) lit g TFEU). The intended reporting requirements for non-financial risks protect third-party interests, because companies could expose themselves to environmental or socio-political risks that investors would choose not to be exposed to.

In case of the reporting requirements for diversity policies, the EU lacks competence and the requirements cannot be based on Art. 50 (2) lit g TFEU. In fact, the Commission claims that diversified bodies improve the success of business, but nothing in support of this opinion is found, neither does an obligation to the best possible success exist. The Commission's concern is far from the protection of interests of investors or third parties.

Subsidiarity

The reason on subsidiarity given by the Commission is not very conceiving. The fact that Member States have different requirements for disclosure gives no legitimacy for action on EU level – particularly since EU regulatory minimum requirements have already been implemented beyond which some Member States have gone. Nevertheless, the plan is consistent with subsidiarity, because changes of EU law are only possible in EU law.

Proportionality

Unproblematic.

Compatibility with EU law

The Directives that are to be amended no longer exist.

Possible Follow-up Action by the EU

The Commission might withdraw its proposal and make a proposal, same in content, in which a change of Directive 2013/34/EU is being announced in a manner that is legally correct.

Conclusion

The Commission's proposal is – preliminary – doomed to fail, since the Directives it amends have been revoked. The requirement for the disclosure of non-financial information leads to undue administrative burdens and costs for businesses. The reporting requirement for the company-specific diversity policies will force companies to include variables in their personnel policies that are completely insignificant the company's success. The EU has no competence to introduce such requirement.