

CALL FOR ADVICE TO THE EUROPEAN SUPERVISORY AUTHORITIES TO COLLECT EVIDENCE OF UNDUE SHORT-TERM PRESSURE FROM THE FINANCIAL SECTOR ON CORPORATIONS

With this Call for Advice, the European Commission invites each of the European Supervisory Authorities (ESAs) to develop a report presenting the evidence and possible advice on potential undue short-term pressure on corporations. The ESAs are expected to assess the extent to which short-termism is present and can be considered problematic. The ESAs should investigate potential sources of such pressure on corporates stemming from the financial sector. If evidence reveals significant issues, the Commission also invites the ESAs to assess whether these issues could be addressed by regulators and to provide advice on areas which regulators should address. The quality of the report should be adequate for the intended use as a basis for considering potential future policy options.

This request implements the action announced in the Commission Action Plan on Financing Sustainable Growth¹, building upon recommendations presented by the Final report of the High Level Expert Group (HLEG) on Sustainable Finance². The action will contribute to the aim of the Sustainable Finance Action Plan to foster transparency and long-termism in financial and economic activity by exploring possible drivers of undue short-termism. It will also indirectly address the aim of mainstreaming sustainability into risk management, as sustainability risks are typically of long-term nature and hence might be missed if investors focus on a shorter horizon.

The request is made in accordance with the founding Regulations establishing the ESAs³, which establish the obligation to protect the public interest by contributing to the short, medium and long-term stability and effectiveness of the financial system, including through ensuring the integrity, transparency, efficiency and orderly functioning of financial markets.

The reports should be based on qualitative, and, when feasible, quantitative sources. The initial evidence discussed in the reports can be based on representative data samples from public and commercial databases, data submitted to the ESAs by the supervised entities and qualitative sources of information, including a review of the most relevant literature. It may also include, but should not be limited to, concrete examples or case studies of undue short-termism, based on the experience of the ESAs in their supervisory capacity. The ESAs are also encouraged to engage with the most relevant stakeholders beyond the supervised entities. The scope of the reports shall be limited to pressures originating in the financial sector and those arising from financial sector regulation.

The need for this request and the scope of the work has been agreed between Commission staff and the ESAs. The delivery of the final report is expected by the end of Q4 2019. The Commission, in close cooperation with the ESAs, may revise and/or supplement this request and revise the timetable accordingly.

The European Parliament and the Council will be informed about this request.

This request will be available on the website of the Directorate-General for Financial Stability, Financial Services and Capital Markets Union once it has been transmitted to the European Supervisory Authorities.

1 https://ec.europa.eu/info/publications/180308-action-plan-sustainable-growth_en

2 https://ec.europa.eu/info/publications/180131-sustainable-finance-report_en

3 Regulations (EU) No 1093/2010, 1094/2010 and 1095/2010 of the European Parliament and of the Council

1. CONTEXT

Putting the EU economy on a sustainable path and managing the transition towards a low carbon economy requires that corporations consider and address relevant long-term risks and opportunities related to their business. Various studies suggest that decisions taken by companies today do not fully reflect these long-term aspects. One factor that may play a role in this regard is pressure from some shareholders, such as those who focus on short-term profit extraction and engage in activist voting. Meanwhile, some companies report that they are subject to short-term market pressures, which incentivise them to under-invest in long-term value drivers including innovation and human capital. Notably, investments that contribute to environmental and social objectives require a long-term orientation. Sustainability faces obstacles to develop in a context where incentives, market pressures and prevailing corporate culture prompt market participants to focus on near-term performance at the expense of the mid to long-term objectives.

Short-termism can be defined as “the focus on short time horizons by both corporate managers and financial markets, prioritizing near-term shareholder interests over long-term growth of the firm”⁴. Various studies refer to a focus on short-term performance in the corporate sector and suggest it may be also relevant for Europe. The Commission asks the ESAs to explore this area of concern in the EU financial sector. The overall objective of this request is to present an initial assessment of evidence on which potential future policy options could be developed, to establish whether or not short-termism in the financial sector presents a significant problem, evaluate the need for regulatory action and, in such case, propose specific areas which policy should address.

This request relates to Action 10 of the Sustainable Finance Action Plan that aims to foster transparency and long-termism in financial and economic activity by exploring possible drivers of undue short-termism.

2. SCOPE OF THE EXERCISE

The Commission invites the ESMA, EBA and EIOPA to investigate and collect evidence of undue short-term pressure from the financial sector on corporations and advise on possible further policy actions consider, if necessary, further steps based on such evidence. We invite each of the ESAs to assess, based on qualitative and, if feasible, quantitative evidence, whether there are such practices that generate undue short-term pressure within their remit and to produce a report summarizing these findings.

The scope of the report is limited to pressures originating in the financial sector (e.g. relation between investors/lenders and corporates, investor behaviour, capital market practices such as earnings guidance, possible effects of regulation on financial market participants).

The reports should include the following:

- 1) Initial evidence of undue short-termism (e.g. considering the evolution of asset holding periods in EU capital markets) in the respective remits of the ESAs, building on the conclusions of the relevant literature and an assessment of the extent of such short-termism is problematic. If feasible, the reports could also discuss the consequences of undue short-termism.
- 2) Assessment of possible drivers of undue short-termism suggested by previous literature, including earnings guidance or remuneration practices in the financial sector.

4 Mason, 2015

- 3) Identification of areas in existing regulations which contribute to mitigating undue short-termism and identification of areas where the rules exacerbate short-term pressures.
- 4) Recommendations building upon the evidence found, assessing whether there is a need for policy action and in which specific areas.

3. PRINCIPLES

The development of the report should be based on the following principles:

- **Autonomy:** The ESAs are free to choose an arrangement for their cooperation, which they consider most efficient to reach the objectives described in this request.
- **Reliable qualitative and quantitative data** should be considered to assess whether there is undue short-term pressure on corporates, subject to the availability of data. The report should be built on diverse, but unbiased sources.
- **Justified recommendations:** if the ESAs include recommendations to the Commission in the report, possible trade-offs with other EU objectives have to also be considered (for instance regarding sustainable corporate governance or market liquidity).
- **Coordination between the ESAs:** while three reports are requested under this initiative, ESMA, EBA and EIOPA need to closely coordinate their work on the reports. The reports should complement each other, in particular where significant cross-sectoral issues arise, and recommendations should not be contradictory.

4. STEPS AND TENTATIVE TIMETABLE

The report is expected by December 2019. In mid-September 2019, a draft featuring preliminary findings should be discussed with the Commission. The Commission will then consider ways to follow up on the report's findings, which may include policy action in this area.

The ESAs can choose the best way to approach the exercise in line with the scope and principles defined above. Due to the nature of the exercise, a close cooperation between the ESAs is highly recommended.

Step 1	Formal request sent	January 2019
Step 2	Collecting evidence and drafting the reports	January 2019 – December 2019
Step 3	Interim drafts and preliminary findings discussed with the Commission	mid-September 2019
Step 4	Discussion of pre-final reports	November 2019
Step 5	Final reports published	December 2019