Malta Association of Compliance Officers

The voice of Compliance Officers in Malta

Company Compliance: The practitioner's perspective

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MACO COUNCIL PRESIDENT

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Investments

Company Service Providers

Credit/Banking

Telecoms, Aviation, Maritime, Pharma, Hospitality, etc

FinServ … FinTech Industry

Pensions

Virtual Financial Assets

Gaming Industry

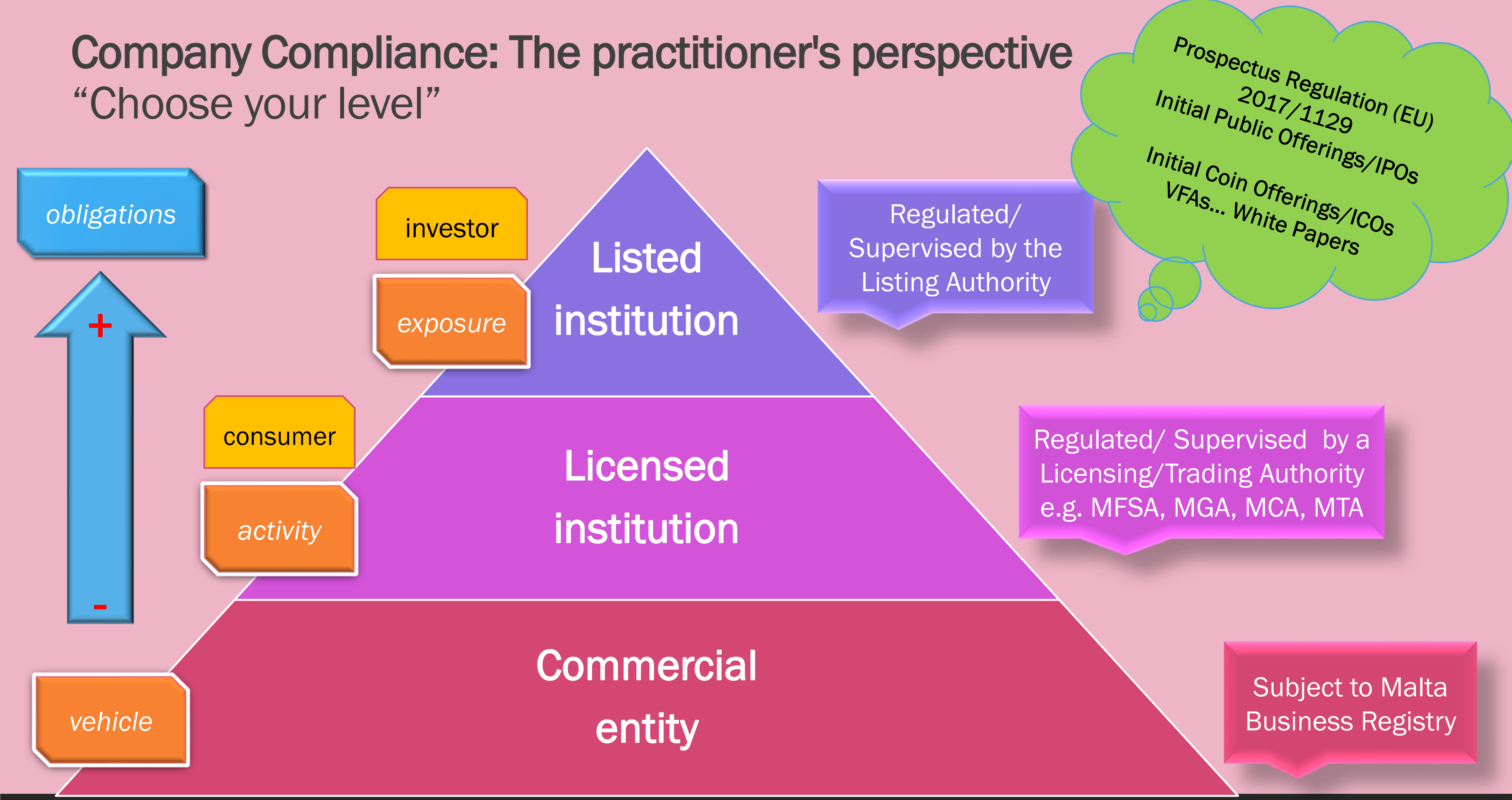
Payments and E-Money

Re/Insurance + Distribution

Fund Management

Company Compliance: The practitioner's perspective

"Choose your level"



Company Compliance: The practitioner's perspective
Sources of Law: Primary and Secondary legislation

1857. Commercial Code (Cap. 13) [*Of Trade In General, Of Bankruptcy …*]

1868. Civil Code (Cap. 16) [*Of Obligations in General inc. Of Fiduciary Obligations intro. 2004 …*]

1954. The Coalition Government appointed a Commission to draft an up-to-date Bill concerning Commercial Partnerships and Companies. Main source of reference was the UK Companies Act, 1948.

1962. Commercial Partnerships Ordinance (Cap. 168) Registrar of Partnerships [*Repealed*]

1995. Companies Act (Cap. 386) [*Partnerships, Limited Liability Company, Company Reconstructions …*] Majority of provisions adopted from UK Companies Act 1985 (amended in 1989), UK Insolvency Act 1986 and various European Union Regulations/Directives on company law.

Registrar of Companies/ROC ⇒ Malta Business Registry/MBR (2018)

2004. Malta becomes an EU Member State… *Acquis Communautaire*

2017. Companies Act (Register of Beneficial Owners) Regulations [*4AMLD requirement*] + Trusts

2020. Register of Beneficial Owners – Associations Regulations (Civil Code) + Foundations

Framework legislation

Acts: Banking, Company Service Providers, Financial Institutions, Insurance Business, Investment Services etc

Ref. https://legislation.mt/Legislation

Company Compliance: The practitioner's perspective

Sources of Law: Local laws + EU Regulations/Directives

Banking Act (Cap. 371)

- Capital Requirements Regulation (CRR2) 575/2013 + Capital Requirements Directive (CRD5) 2013/36/EU
- Bank Recovery and Resolution Directive (BRRD2) 2014/59/EU
- Deposit Guarantee Schemes Directive (DGSD2) 2014/49/EU
- Single Resolution Mechanism Regulation (SRMR2) 806/2014

Financial Institutions Act (Cap. 376)

- Payment Services Directive (PSD2) 2015/2366/EU
- Electronic Money Directive (EMD2) 2009/110/EC

Investment Services Act (Cap. 370)

- Markets in Financial Instruments Directive (MiFID2) 2014/65/EU
- Markets in Financial Instruments Regulation (MiFIR) 600/2014
- Prospectus Regulation 2017/1129
- Market Abuse Regulation (MAR) 596/2014 + Market Abuse Directive (MAD2) 2014/57/EU

Here is where we find the actual functional elements of the law (in detail) – prudential and conduct

Company Compliance: The practitioner's perspective

Sources of Law: Local laws + EU Regulations/Directives

- Undertakings for the Collective Investment in Transferable Securities Directive (UCITS5) 2009/65/EC
- Alternative Investment Fund Managers Directive (AIFM) 2011/61/EU
- European Venture Capital Funds Regulation (EuVECA) 345/2013
- European Long-term Investment Funds Regulation (ELTIFs) 2015/760
- Money Market Funds Regulation 2017/1131
- European Market Infrastructure Regulation (EMIR2) 648/2012
- Central securities depositories Regulation 909/2014

> Building block legislation that converges towards a Single Rulebook approach (ref. EU Commission Consultation Supervisory Convergence and Single Rulebook 12.03.21 - 21.05.21)

Insurance Business Act (Cap. 403) + Insurance Distribution Act (Cap. 487)

- Pan-European Personal Pension Product Regulation (PEPP) 2019/1238
- Risk management and supervision of insurance companies Directive (Solvency 2) 2009/138/EC
- Insurance Distribution Directive 2016/97/EU
- Institutions for Occupational Retirement Provision Directive (IORP2) 2003/41/EC

Etc... Ref. ec.europa.eu/info/law/law-topic/eu-banking-and-financial-services-law_en

Company Compliance: The practitioner's perspective
Sources of Law: Further regulatory strata

European System of Financial Supervision (ESFS). The system set up for the supervision of the financial sector is made of: European Securities and Markets Authorities/ESMA, European Banking Authority/EBA and European Insurance and Occupational Pensions Authority/EIOPA.

- Guidelines (GLs). To promote supervisory convergence ESAs have the power to issue guidelines addressed to competent authorities or market participants. ESAs are entitled to receive information from competent authorities/market participants if they comply with the GLs and publish the reasons for non-compliance.
- Technical Standards. ESAs are entitled to elaborate technical standards to be submitted to the Commission for endorsement. Depending on the level 1 mandate ESAs may develop Regulatory Technical Standards (RTSs) endorsed by Commission Delegated Acts per Article 290 TFEU or Implementing Technical Standards (ITSs) adopted by Commission Implementing Acts per Article 291 TFEU.

Malta Financial Services Authority Act (Cap. 330) Art.16(2) "Authority may, for the better carrying out of the provisions of this Act or any other Act administered by it, from time to time:

(a) issue and publish Rules regulating the procedures and duties of persons licensed or authorised by it, or falling under its regulatory or supervisory functions […]

(b) issue a Directive in writing requiring a person to do or to refrain from […]"

Company Compliance: The practitioner's perspective

Sources of Law: A bird's eye view (FinServ)

EU

Regulations &/or Directives

ESAs Guidelines/ RTSs/ ITSs

MFSA applies these as issued

Malta

Acts of Parliament

Legal Notices/ Regulations

MFSA Rules/ Directives

MFSA Guidelines/ Circulars

Others

e.g. ECB adopts Regulations; Decisions without addressees/ to individual banks; Opinions; (Supervisory) Guidelines and instructions; (Supervisory) Recommendations

e.g. CBM Directives (1) re use of payment systems, (19) use of cheques and bank drafts

Company Compliance: The practitioner's perspective
The responsible protagonists: the generalists

"director" includes any person occupying the position of director of a company by whatever name he may be called carrying out substantially the same functions in relation to the direction of the company as those carried out by a director (*Companies Act*, Art.2(1))

A. of Assn: directors' powers delegation, e.g. managing director or director/s holding other executive office/s.

Directorship: a position as a member of the management body of an institution or another legal entity.

Executive director/ED: person responsible for effectively directing the business of an entity.

Non-executive director/NED: person responsible for overseeing and monitoring management decision making without executive duties within an entity.

(*ESMA and EBA Final Report on Joint Guidelines on the assessment of the suitability of members of the management body and key function holders under Directive 2013/36/EU and Directive 2014/65/EU*, EBA/GL/2021/06, ESMA35-36-2319 – 02.07.21 … apply from 31.12.21)

Board has the first level responsibility of executing the 4 basic roles of corporate governance: accountability, monitoring, strategy formulation and policy development. [Directors as keepers of the licence]

(GL.4., *MFSA Corporate Governance Guidelines for Public Interest Companies*, 2006)

Company Compliance: The practitioner's perspective
The responsible protagonists: the specialists

The 3 lines (*of defence*) model: identifying the functions responsible for addressing and managing risks.

1: Operating business lines: take risks and are directly responsible for the execution and the operational management and on a permanent basis. Consumer-facing. Front, middle and back-office duties.

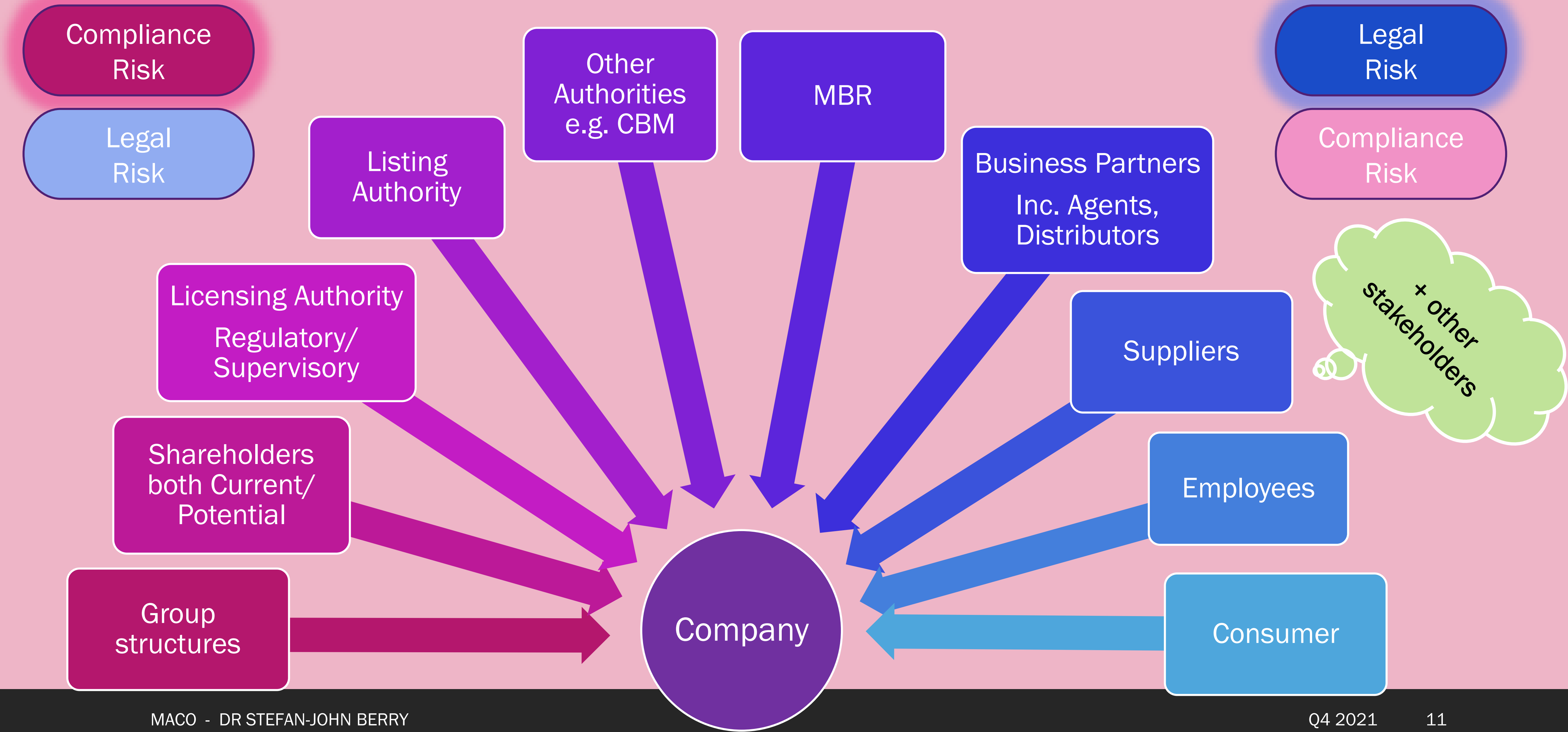
2: Risk Function facilitates the implementation of a sound risk management framework throughout the institution and has responsibility for further identifying, monitoring, analysing, measuring, managing and reporting on risks and forming a holistic/universal view on all risks (individual and consolidated basis). Compliance Function monitors the legal and regulatory requirements and internal policies, provides advice on compliance to the management and relevant staff, and establishes policies and processes to manage compliance risks and to ensure compliance. Authority-facing.

3: independent internal audit function: conducts risk-based and general audits and reviews the internal governance arrangements, processes and mechanisms to ascertain they are effective and sound, implemented and consistently applied. IAF is in charge of the independent review of 1 and 2.

Depending on the nature of the authorisation/licence/registration, Board may be required to appoint key function holders/KFHs as specialised delegates in the respective function (subject to a fitness and properness assessment, Personal Questionnaire/PQ). (*MFSA Guidance on the Fitness and Properness Assessments*, 2019)

Company Compliance: The practitioner's perspective

An interactive biosphere



Company Compliance: The practitioner's perspective

Compliance vs Legal. Corporate or Internal Governance?

E.g. Your company processes dangerous, combustible materials. Having fire insurance will reduce financial liability if a facility burns down. You should contract a good fire insurance and keep all your fire insurance-related documents in order c/o the insurance team… <u>But</u>, just having a cover does not prevent fires. You are also to prevent facilities from burning down by having policies/procedures, training and controls in place, in sync with requirements and best practice, and keep monitor to make sure processes are reliable c/o the safety team… Both teams protect the company, but in different ways.

Legal Team protects from liability. Compliance Team protects the company from itself!

Are they both indispensable? No. Legal can be easily outsourced, while compliance – as a rule – may not.

While Corporate Governance/CG has a wider scope and includes issues that concern the shareholders and other stakeholders of an institution, Internal Governance/IG focuses on the responsibility of the Board (*MFSA BR12 Annex 2C*) and includes all standards and principles concerned with setting an institution's objectives, strategies and risk management framework; how business is organised; how responsibilities and authority are defined and clearly allocated; how reporting lines are set up and what information they convey; how internal control framework is organised and implemented, inc. accounting procedures and remuneration policies. IG also covers sound information technology systems, outsourcing arrangements and business continuity.

(Ref. *EBA Final Report on Guidelines on Internal Governance*, EBA/GL/2021/05 … apply from 31.12.21)

Company Compliance: The practitioner's perspective
Corporate Governance. MT perspective: the changing landscape

05.02.20. *Stakeholder Consultation* on revisiting corporate governance framework for entities authorised by the MFSA and listed companies. MFSA proposed a review of the existing framework, to raise standards, practices, and processes of Governance by the authorised/listed persons and ensure good Governance is considered as a top priority and embedded in culture by the Board of Directors and senior management.

18.05.21. *Feedback Statement*. Most stakeholders appreciate that good Corporate Governance is crucial and the review will benefit the FinServ industry and the jurisdiction in general. Yet, respondents raised a number of concerns and put forward several views and recommendations re the proposed framework.

MFSA is proposing a principles-based Corporate Governance Code applicable to all entities MFSA-authorised and Listed Companies with a possibility of having sector-specific Guidelines and/or MFSA Rules, supporting the Code. Proportionality is central. Principles will be applied on a best effort basis; complemented by binding Rules and/ or guidance notes (or sectoral specific Codes if necessary) to apply to different typesets.

- Board of Directors. To enhance the role of the Board and its efficacy, MFSA proposes:
    - in principle, exact composition will not be stipulated, but such requirement would be reflected either as part of the rules, guidance notes or sectoral Codes applicable for the various sectors, depending on type of entity/ authorisation held (as applicable).
    - the diversity element, as a provision supplementing the board composition main principle, thereby promoting social and professional diversity.

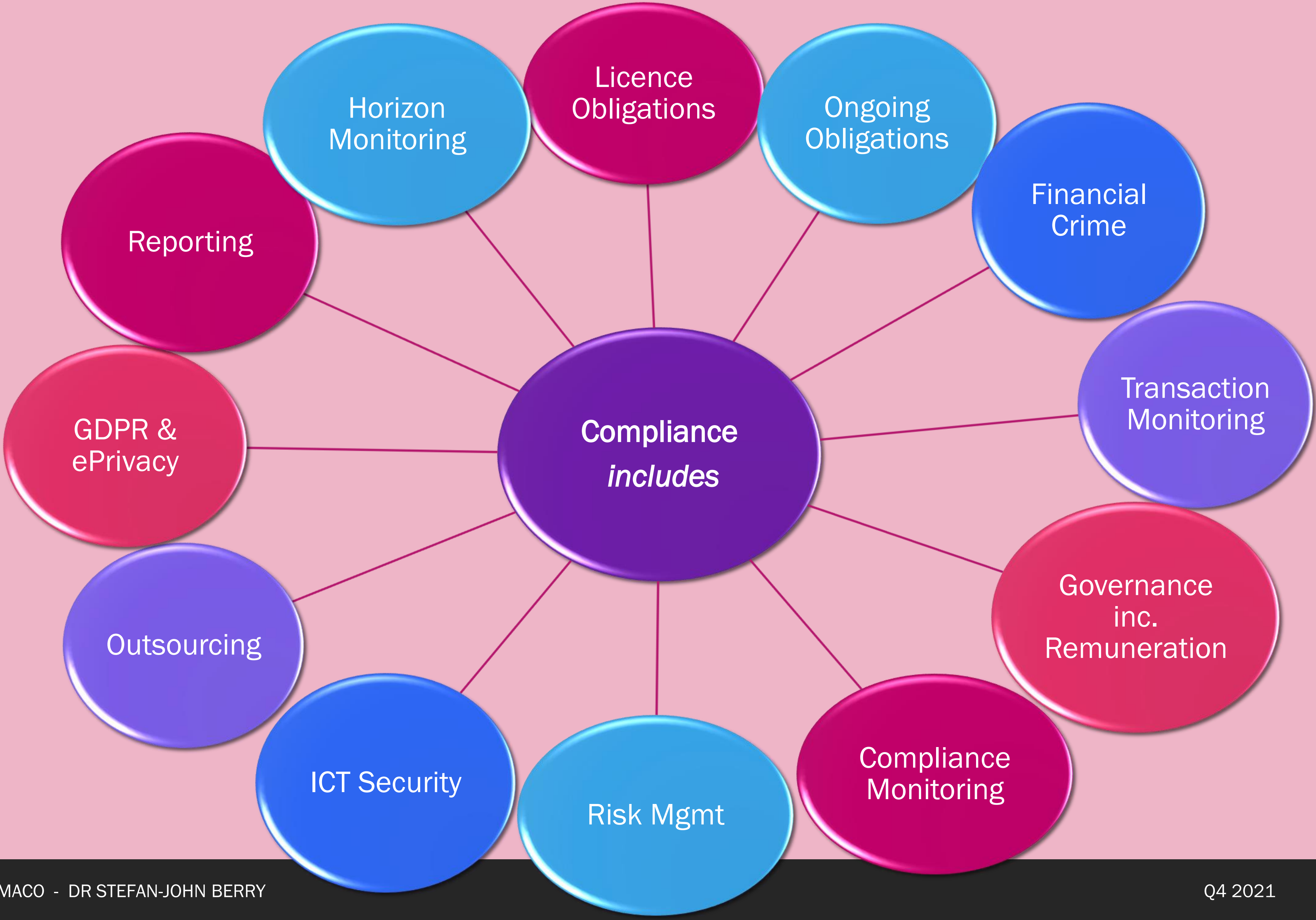
Company Compliance: The practitioner's perspective
Corporate Governance. MT perspective: the changing landscape

- a principle re a formal and transparent procedure to appoint new directors, ensure they possess relevant skills, experience and knowledge to fulfil duties effectively.
- Reference to the need to provide an induction programme to any new directors.
- MFSA will include a core principle on the responsibilities of Board in executing the roles of Corporate Governance (to include monitoring of financial health of company).
- "Remuneration" to cover executive remuneration, besides Directors. Have formal and transparent procedures re the determination of remuneration.
- Evaluation of Board and Committees. Provisions supporting this principle will include guidance on how this evaluation should be carried out, by who and where disclosed.
- Re Board meetings, the relevant principle will be drafted in a general way; it will not be prescriptive in certain matters (frequency of board meetings etc.)
- A Register of Interests will be required, allowing flexibility e.g. re who would be responsible for the maintenance, managing and overseeing disclosure of conflicts.
- Chair and CEO should not be exercised by the same person, as per checks and balances associated with international Corporate Governance practices. Proportionality allowed.
- CoSec. Some claim it merits more visibility; others claim Companies Act is adequate already. MFSA to reconsider.
- Compliance Officer. MFSA is considering adopting a holistic approach and decided not to pursue introduction of a principle defining CO's role and responsibilities.

Company Compliance: The practitioner's perspective
Corporate Governance. MT perspective: the changing landscape

- MFSA proposes enhancing engagement/dialogue with stakeholders (to be defined), shareholders, employees.
- Provisions re appointment of Committees: Audit; Risk; Remuneration; Nomination; and Good Governance. Given this Code will be on a best effort basis, proportionality re Committees shall be addressed. Responsibilities should be clear, in writing, agreed by Board and made publicly available.
- Board is responsible for risk management, risk appetite and assessing/monitoring the main risks and procedures, to be kept updated. Principle on Internal Controls (inc. internal and external Audit) and oversight of internal controls.
- MFSA considers adequate arrangements to mitigate the risk of being used to commit Financial Crime, particularly ML/TF, to be crucial. It intends to include reference to the AML/CFT controls as part of Internal Controls principle.
- MFSA is considering to introduce Continuous Professional Development for Directors, inc. requirement for a number of mandatory CPD hours, it will be including provision for the board to ensure adequate ongoing training and development, in the Structure and Composition of the Board principle.
- Disaster Recovery & Business Continuity. MFSA to issue guidance (i) minimum contents of plans; (ii) conditions for entities that are solely B2B; (iii) conditions for entities with individual customers as main stakeholders.
- Further steps are needed to enhance the quality of Governance Disclosures.
- Corporate Social Responsibility: inc. a principle urging firms to disclose policies re business ethics, environment and where material, to the company, social issues, human rights and other public policy commitments.

Code of Principles may, in due course, be the subject of another industry consultation, to allow stakeholders to comment, suggest and submit contributions.


Compliance
includes
Licence Obligations
Ongoing Obligations
Financial Crime
Transaction Monitoring
Governance inc. Remuneration
Compliance Monitoring
Risk Mgmt
ICT Security
Outsourcing
GDPR & ePrivacy
Reporting
Horizon Monitoring

Company Compliance: The practitioner's perspective

EU: Challenges and Prospects

Challenges to EU company and financial law: The corporate reality

Since 1970s, new practices of corporate governance advocated the empowerment of shareholders over corporate management and governing bodies. Shareholder value has been affirmed as corporate groups' main objective, linked to increase in current share market prices and justified by an efficient financial market hypothesis. This shareholder primacy has reshaped the balance of interests in the enterprise and between the enterprise and society.

This transformation: (a) did not affect EU company law directly, but its use and its margins; new corporate practices and new modes of regulation were adopted and implemented re the organisation of corporate groups, corporate governance, financial reporting and investment; and (b) is driven by 'financialisation', a complex socio-economic phenomenon that favours financial mind-sets, interests and actors in economy and to society.

Thus, corporate groups have reorganised to exploit parent-subsidiary relationships; which reorganisation then undermines corporate social responsibility by enabling aggressive corporate strategies aimed to avoid taxation, environmental, social liabilities, etc. These transformations challenge the EU institutional framework in company and financial affairs, threatening corporate social responsibility and sustainability.

Company Compliance: The practitioner's perspective
EU: Challenges and Prospects

The past balance of interests was lost, while the new one empowers shareholding investors and relinquishes a duty of care to other stakeholders. Thus, overall corporate impact on economy and society should be reconsidered to rebalance interests. In this new context, EU company and financial law has to reaffirm its role to assure that the EU principles of the law are protected and the social balance of interests is assured.

EU company and financial law and regulation may respond to these challenges by reinstating a core social license. Recent transformations have displaced the original intention of the focus on the enterprise as a going concern; instead, the focus is now on financial investment and the facilitation of active financial markets.

EU institutional framework needs to reinstate the social balance of interests by considering the enterprise as an autonomous entity that is accountable and responsible to economy and society. Relevant fields of interest for law and regulation may be reconsidered by pointing to the specific needs of maintaining the enterprise entity as a going concern to reconcile the joint interest for stakeholders (inc. shareholders) and society. These fields include (but are not limited to):

– Enterprise groups and corporate social responsibility
– Financial reporting and transparency
– Financial investment and asset management

"the 2008 global financial crisis has led to renewed public attention… The social contract that implicitly binds the companies with the rest of society has come under greater scrutiny", Sofia Karagianni, Policy Lead, Cleantech Group, Europe Initiative, 26.10.21. World Economic Forum

Company Compliance: The practitioner's perspective
EU: Challenges and Prospects

EU rules on Company Law and Corporate Governance. The purpose of EU rules in this area is to:

1. enable businesses to be set up and to carry out operations anywhere in the EU
2. provide protection for shareholders/stakeholders (corporate governance issues)
3. make business more efficient, competitive and sustainable in the long term
4. encourage businesses based in different EU countries to cooperate with each other.

Corporate governance is a focal point when executing Commission Action Plan: Financing Sustainable Growth (08.03.18), especially Action 10 [*Fostering sustainable corporate governance and attenuating short-termism in capital markets*]. In line with the overall objective of a just transition to a sustainable economy and a post-COVID recovery, Commission's Communications on the European Green Deal (11.12.19) and the Recovery Plan for Europe (27.05.20) confirm the need to embed sustainability in corporate governance.

Companies are to focus on long-term sustainable value creation rather than short-term benefits. To better align the interests of companies, shareholders, managers, stakeholders and society. It would help companies to better manage sustainability-related matters in their own operations and value chains as regards social and human rights, climate change, environment, etc.

- 09.12.19. Reg. 2019/2088 on sustainability-related disclosures in FinServ sector, applies from 10.03.21.

Company Compliance: The practitioner's perspective
EU: Challenges and Prospects

Art.9. For this Regulation, these shall be environmental objectives: climate change mitigation; climate change adaptation; sustainable use and protection of water and marine resources; transition to a ***circular economy***; pollution prevention and control; protection and restoration of biodiversity and ecosystems.

- 18.06.20. Reg. 2020/852 on establishment of **framework to facilitate sustainable investment**, amends Reg. 2019/2088 (Taxonomy Regulation, establishes an EU framework for classification of sustainable economic activities), staggered application in 01.01.22 and 01.01.23.
- 30.07.20 (till 08.10.20) Roadmap issued. Commission published findings of its Study on Directors' Duties and Sustainable Corporate Governance. EU listed companies still tend to focus on short-term benefits of shareholders. Main findings: there is **growing pressure from investors and a lack of a strategic perspective over sustainability risks, impacts and opportunities. Board expertise and remuneration structures pose challenges** for sustainability. There is a lack of stakeholder input in the company's decision-making and limited enforcement of directors' duties when it comes to acting in the company's long-term interests.
- 26.10.20 (till 08.02.21) Consultation on Sustainable Corporate Governance (SCG) launched; asks how EU can best help businesses in how they operate, to a **transform to a more sustainable economy** and **ensure environmental and social interests are embedded in business strategies**. Consultation aims to gather:
  - views of stakeholders on the need and objectives for EU intervention and different policy options;
  - data that can be used to better assess the costs and benefits of different policy options;
  - additional knowledge *viz* national frameworks, enforcement mechanisms, current jurisprudence.
- Planned for Q4 2021. EU legislative proposal on Sustainable Corporate Governance.

Company Compliance: The practitioner's perspective
EU: Challenges and Prospects

- 25.03.21. EU Financial Stability Commissioner and Justice Commissioner explain the importance of aligning due diligence law proposal with reforms to the non-financial reporting directive (NRFD)
- 18.05.21. Results to Public Consultation issued; help Commission run an Impact Assessment analysis to examine in particular the economic, environmental and social impacts of the initiative.
- 01.06.21. Paper "Environmental Due Diligence in EU Law: Considerations for Designing EU (Secondary) Legislation", German Environment Agency. Overview of conceivable concepts for designing environmental due diligence's "material scope" (general clauses, ways of referencing substantive environmental norms).
- 22.06.21. MEPs sent a letter to Commission reiterating key demands of EP's resolution.
- 02.07.21. Office UN High Commissioner for Human Rights/OHCHR recommendations to Commission.
- 28.07.21. Commission's President replies to EP on expectations re Sustainable Corporate Governance. "We are currently preparing the impact assessment for this legislative initiative, taking into account a large number of replies to the public consultation".
- 13.10.21. Briefing by Friends of the Earth Europe calls on EU to enshrine obligations for corporations to respect environment & climate in law.
- 27.10.21. MEPs request Commission to address barriers to justice for victims of corporate abuse in global value chains in order to enable private enforcement of future Corporate Due Diligence rules.
- 31.10. to 12.11.21. COP26: the 2021 United Nations Climate Change Conference. (COP1, Berlin in 1995)

Company Compliance: The practitioner's perspective

EU: Challenges and Prospects … Focus on Sustainability

Sustainability = *meeting the needs of the present without compromising the ability of future generations to meet their own needs* – UN Brundtland Commission (Report), Our Common Future, which popularised "sustainable development", 1987

Sustainability in Corp. Governance *encourages businesses to consider environmental (inc. climate, biodiversity), social, human and economic impact in their business decisions, and to focus on long-term sustainable value creation rather than short-term financial value* – EU Consultation on Sustainable Corporate Governance (SCG) 2020

Commission's Agenda is to convert EU's economy into a circular one; ensuring coherence between industrial, environmental, climate and energy policy to create an optimal business environment for sustainable growth, job creation and innovation.

- 28.11.18. Commission presented its **Strategic Long-term Vision for a prosperous, modern, competitive and climate-neutral economy by 2050**; how Europe can lead the way to climate neutrality by investing in realistic technological solutions, empowering citizens and aligning action in key areas such as industrial policy, finance or research – while ensuring social fairness for a just transition.
- 11.03.20. Communication on new **Circular Economy Action Plan**. A model of production and consumption, which involves sharing, leasing, reusing, repairing, refurbishing and recycling existing materials and products as long as possible. In this way, the life cycle of products is extended.

EU citizens expect companies to understand their +/- impacts on society, environment; and **prevent, manage, and mitigate any negative impact they cause**: corporate social responsibility (CSR) or responsible business conduct (RBC). Authorities are key in supporting and encouraging companies to be responsible.

EU introduced a mix of voluntary and mandatory actions to promote CSR and actuate UN Guiding Principles on business and human rights (UNGPs), 2011 and UN 2030 Agenda for Sustainable Development, 2015.

Company Compliance: The practitioner's perspective

EU: Challenges and Prospects … Focus on Sustainability … CSR

Voluntarily doing social good

- 25.10.11. Commission’s Renewed EU Strategy 2011-14 for CSR, combining horizontal approaches to promote CSR/RBC with more specific approaches for individual sectors and policy areas. (COM(2011) 681)
- 20.03.19. Commission Staff Working Document on Corporate Social Responsibility, Responsible Business Conduct and Business & Human Rights giving an overview of Commission's and European External Action Service's (EEAS) progress implementing CSR/RBC and business and human rights. (SWD(2019) 143)

What is CSR? “companies integrate social and environmental concerns in their business operations and in their interaction with their stakeholders on a voluntary basis” COM(2001)366 CSR should be company led. Companies are responsible for their impact and may become socially responsible by (A) integrating social, environmental, ethical, consumer and human rights concerns into their business strategy and operations; and (B) following the law. Public authorities play a supporting role through voluntary policy measures and complementary regulation.

- For enterprises, CSR/RBC provides important benefits in terms of risk management, cost savings, access to capital, customer relationships, HR management, sustainability of operations, ability to innovate and also profit
- For EU economy, CSR/RBC makes companies more sustainable and innovative… more sustainable economy
- For society, CSR/RBC offers a set of values on which we can build a more cohesive society and on which we can base the transition to a sustainable economic system.

Company Compliance: The practitioner's perspective

EU: Challenges and Prospects … Focus on Sustainability … CSR

Commission promotes CSR in the EU and encourages companies to adhere to international guidelines and principles. EU's policy is built on its 2011 Renewed Strategy, which aims to align European and global approaches to CSR and stresses the importance of enhancing the visibility of CSR and disseminating good practices, through the integration of CSR into education, training and research. Strategy also improves self and co-regulation processes and companies' disclosure of social and environmental information.

Responsible Business Conduct (RBC) is an alternative term introduced by the OECD in close cooperation with business, trade unions and non-governmental organisations. OECD defines RBC as "making a positive contribution to economic, environmental and social progress with a view to achieving sustainable development and avoiding and addressing adverse impacts related to an enterprise's direct and indirect operations, products or services". (OECD Guidelines for Multinational Enterprises, 2011 Edition)

Small and medium-sized enterprises (SMEs) are the most common type of businesses in the EU. They may not know or use the terms 'CSR' or 'RBC', but through their close relations with employees, the local community and their business partners, they often have a naturally responsible approach to business. For most, the process by which they meet their social responsibility goals is likely to remain informal and intuitive. Nevertheless, CSR/RBC among SMEs is promoted by developing CSR handbooks and manuals.

May be aligned to Conduct upholding good AML&CFT requirements and Anti-Bribery /Corruption standards.

Company Compliance: The practitioner's perspective

EU: Challenges and Prospects … Focus on Sustainability … ESG

Non-financial reporting

Environmental, Social and Governance (ESG)

- 11.12.19. Commission's Communication on the European Green Deal: intention to review **Non-Financial Reporting Directive (NFRD)** as part of strategy to strengthen sustainable investment. Current NFRD enables investment community, consumers and other stakeholders to evaluate non-financial performance of large companies, encouraging them to develop a more responsible approach to business. Dir.2014/95: large undertakings that are public-interest entities exceeding average of 500 employees shall include in management report a non-financial statement with info. on undertaking's development, performance, position and impact of its activity on, as a minimum, environmental, social and employee matters, human rights, anti-corruption and bribery matters. **"comply or explain". Weak accountability/enforcement.**
- 20.02.20. Commission Consultation (closed 11.06.20) to collect stakeholders' views re possible revisions to NFRD provisions.
- 25.06.20. Commission asked European Financial Reporting Advisory Group (EFRAG) for technical advice to **undertake preparatory work to elaborate possible EU non-financial reporting standards in a revised NFRD.**
- 08.03.21. EFRAG published 2 reports (a) with recommendations on development of EU sustainability reporting standards and (b) possible changes to EFRAG's governance and funding, if it were to become the EU sustainability reporting standard setter.

Company Compliance: The practitioner's perspective

EU: Challenges and Prospects … Focus on Sustainability … ESG

- 21.04.21. Commission proposal for a Corporate Sustainability Reporting Directive (CSRD), to revise and strengthen existing rules introduced by the Non-Financial Reporting Directive (NFRD), and bring - over time - sustainability reporting at par with financial reporting. Companies will have to report how sustainability issues affects their business and the impact of their activities on people and the environment.

Proposal extends EU's sustainability reporting requirements to all large companies and all listed companies. This means nearly 50,000 companies in the EU would be asked to follow detailed EU sustainability reporting standards (an increase from 11,000 companies subject to existing regime). Commission proposes development of standards for large companies and separate, proportionate standards for SMEs that non-listed SMEs can use voluntarily. Overall, the proposal aims to (A) ensure companies report reliable and comparable sustainability information needed by investors and other stakeholders (to facilitate a consistent flow of sustainability information through the financial system), and (B) simplify companies' reporting process. Many companies are currently under pressure to use an array of different sustainability reporting measures. Proposed standards try to provide companies with a single solution that meets information needs of investors and other stakeholders.

In the European Parliament, the file has been referred to the Committee on Legal Affairs (JURI).

In the Council, the work has started in the working party on company law (sustainability).

Company Compliance: The practitioner's perspective

EU: Challenges and Prospects … Focus on Sustainability and Due Diligence

Voluntary, non-enforceable due diligence standards have existed for quite a while, without the desired effect. In the very near future, companies will have to undertake comprehensive due diligence efforts to assess their impact on all stakeholders and be further encouraged to reduce any negative impact. France and Germany have passed legislation on due diligence requirements. A Dutch law introduces a duty of care re prevention of child labour. Others (Sweden, Finland, Denmark) are debating similar laws. While business in Europe may prefer to self-regulate, differences in due diligence requirements in 27 Member State are too cumbersome.

10.03.21. EU Parliament Resolution on corporate due diligence and corporate accountability: "voluntary due diligence standards have limitations and have not achieved significant progress in preventing human rights and environmental harm". Commission to "submit without undue delay a legislative proposal on mandatory supply chain due diligence", per recommendations in the Annex. (P9_TA(2021)0073, 2020/2129(INL))

Accountability of companies covered by the (draft) Directive extends beyond a company's own activities; to those linked to their operations, those in a business relationship or in their value chain (i.e. all activities, operations, business relationships and investment chains). It includes entities with which the company has a direct or indirect relationship, upstream and downstream.

Many considerations are still open for debate and key definitions need to be agreed upon.

Commission is expected to publish this new legislative proposal on 08.12.21.

Company Compliance: The practitioner's perspective
EU: Challenges and Prospects … Focus on Sustainability … DD

Mandatory value/supply chain due diligence

Article 2. Scope. This Directive shall apply to:

- ***large undertakings** governed by the law of a Member State or established in the EU*
- ***all publicly listed** and/or **high-risk* small and medium-sized undertakings***
- *any of the above not established in EU, when they operate (sell goods or services) in the internal market.*

* yet to be defined. **Directive 2013/34/EU** on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings (as amended by **Directive 2014/95/EU** re disclosure of non-financial and diversity information by certain large undertakings and groups) – as transposed by **Legal Notice 289/2015** General Accounting Principles for Small and Medium-Sized Entities) Regulations/GAPSME and amendments to the **Companies Act.**

Article 3(2) **Small undertakings** (do not exceed at least 2 of 3 criteria): (a) balance sheet total: EUR 4mln; (b) net turnover: EUR 8mln; (c) average number of employees during the financial year: 50.

Article 3(3) **Medium-sized undertakings** (do not exceed at least 2 of 3 criteria): (a) balance sheet total: EUR 20mln; (b) net turnover: EUR 40mln; (c) average number of employees during the financial year: 250.

Article 3(4) **Large undertakings** (exceed at least 2 of 3 criteria): (a) balance sheet total: EUR 20mln; (b) net turnover: EUR 40mln; (c) average no. employees during financial year: 250.

Article 19a(1). **Large undertakings** which are public-interest entities exceeding on their balance sheet dates the criterion of the average number of 500 employees during the financial year shall include in the management report a non-financial statement […]

Article 4. Due diligence strategy. 2. Undertakings shall in an ongoing manner make all efforts within their means to identify and assess, by means of a risk based monitoring methodology [...]

Article 5. Stakeholder engagement. 1. [...] undertakings carry out in good faith effective, meaningful and informed discussions with relevant stakeholders when establishing and implementing their DD strategy.

Article 6. Publication and communication of DD strategy. 1. [...] undertakings make their most up to date DD strategy, or the statement including risk assessment, publicly available and accessible for free [...] websites.

Article 7. Disclosure of non-financial and diversity information. This is without prejudice to obligations imposed by Directive 2013/34/EU to include non-financial statement in their management report [...]

Article 8. Evaluation and review of DD strategy. 1. Evaluate effectiveness and appropriateness of their DD strategy and of its implementation at least once a year, and revise it accordingly [...]

Article 9. Grievance mechanisms. 1. Provide a grievance mechanism, both as an early-warning mechanism for risk-awareness and as a mediation system, allowing any stakeholder to voice reasonable concerns [...]

Article 10. Extra-judicial remedies. 1. [...] When an undertaking identifies that it is directly linked to an adverse impact [...] it shall cooperate with the remediation process to the best of its abilities.

Article 12. Each Member State shall designate one or more national competent authorities responsible for the supervision [...] and for the dissemination of due diligence best practices.

Sustainable Corporate Governance – *Public Consultation*

Environmental, Social and Governance (ESG) – *Dir. 2013/34 amended by Dir. 2014/95 Non-Financial Reporting (NFRD): "comply or explain"*

to be revised by the Proposed Corporate Sustainability Reporting Directive (CSRD)

Reg. (EU) 2019/2088 on sustainability-related disclosures in the FinServ sector + **Reg. (EU) 2020/852** on establishment of framework to facilitate sustainable investment (Taxonomy Regulation)

Mandatory value/ supply chain Due Diligence – *Proposed Directive on corporate due diligence and corporate accountability (wider remit than current NFRD)*

Corporate Social Responsibility (CSR) – *Commission Green Paper, Strategy, SWD: "on a voluntary basis"*

"To what point the restrictions imposed on private-sector autonomy can extend in order to shape companies' sustainability strategies", Sofia Karagianni, 26.10.21.

Company Compliance: The practitioner's perspective

More reference material and further reading

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Karagianni, S., “The EU wants business to be sustainable. But it must empower companies to do that”, Cleantech Group, 26.10.21, www.weforum.org/agenda/2021/10/european-union-sustainable-corporate-governance

Reg. (EU) 2019/2088 on sustainability-related disclosures in the financial services sector

Regulation applies generally from 10.03.21, with certain exceptions (to accommodate development and adoption of the related regulatory technical standards). Compliance will be monitored by the relevant competent authorities.

Who is in-scope? The Regulation applies to a broad range of:

- fund managers, pension providers, insurance-based investment product providers, MiFID investment firms and credit institutions (Financial Market Participants/FMPs); and
- financial advisers, inc. certain insurance intermediaries and providers of investment advice (Financial Advisers/FAs).

The complete list of in-scope entities, based on the definitions used in the Regulation, is set out in the Schedule. The Regulation includes limited exemptions for:

- (subject to a Member State not deciding otherwise) insurance intermediaries which provide insurance advice with regard to "IBIPs" (insurance undertakings which make available insurance-based investment product); and
- investment firms which provide investment advice, provided they employ fewer than 3 persons.

Broadly, Regulation seeks to lay down harmonised rules on transparency to promote integration of sustainability risks into investment processes and the disclosure of such risks to investors. "sustainability risk" = an environmental, social or governance event or condition that, if it occurs, could cause an actual or a potential material negative impact on the value of an investment.

FMPs and FAs have similar (to include certain descriptions in pre-contractual disclosures), but different, obligations. FMPs' websites to publish: Investment Policies; Entity-level Considerations; Remuneration Policies; ESG Products.

FAs' websites to publish: Investment Policies; Entity-level Considerations; Remuneration Policies.

While the Regulations do set out some specific compliance requirements, most of the detail how to address obligations created by the Regulation will ultimately be prescribed by the corresponding Regulatory Technical Standards/RTSs.

Reg. (EU) 2020/852 establishment of a framework to facilitate sustainable investment, and amending Reg. (EU) 2019/2088

01.01.22. Application of the requirements for climate-related objectives

01.01.23. Application of the requirements for all other environment-related objectives

It aims to define EU-recognized criteria for identifying sustainable activities. This defines the minimum criteria that economic activities should comply with to be considered environmentally sustainable and contribute substantially to one or more of the environmental objectives: 1. Climate change mitigation; 2. Climate change adaptation; 3. Sustainable use and protection of water and marine resources; 4. Transition to a circular economy; 5. Pollution prevention and control; 6. Protection and restoration of biodiversity and ecosystems.

It also sets out 4 conditions that an economic activity has to meet to be recognised as Taxonomy aligned: making a substantial contribution to at least one environmental objective; doing no significant harm to any other environmental objective; complying with minimum social safeguards; complying with the technical screening criteria.

EU Parliament and Council prioritised economic activities that can make the most relevant contribution to the 2 environmental objectives under consideration. This first Delegated Act focuses on climate objectives (no. 1 and 2) and includes activities that most relevant for reductions in greenhouse gas emissions and for improving climate resilience.

Companies (financiall or not) subject to reporting obligations under NFRD are to disclose how and to what extent their activities are associated with environmentally sustainable economic activities. For non-financial companies, that will involve reporting against certain key performance indicators (“KPIs”), namely the proportion of their turnover, capital expenditure (“CapEx”) or operating expenditure (“OpEx”) that is taxonomy-aligned. For financial companies, such as banks and asset managers, where those KPIs would not be as relevant or useful, different KPIs are developed, e.g. KPIs that banks will have to disclose will be their ‘Green Asset Ratio’ (“GAR”), showing the extent to which a bank’s financing activities in their banking books are Taxonomy-aligned.

Thank you

Malta Association of Compliance Officers

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