

## **CAFOD response to the Corporate Governance Reform Code review**

*"A fragile world, entrusted by God to human care, challenges us to devise intelligent ways of directing, developing and limiting our power."*

Pope Francis, Encyclical Letter Laudato Si on Care for our Common Home, Section 78, 2015.

CAFOD is the official development and humanitarian agency of the Catholic Bishops Conference of England and Wales, working with partner organisations in more than forty countries globally to support sustainable development. Businesses large and small have a huge impact on every aspect of our lives so it is essential that the rules which govern how the private sector operates are fair and effective. Businesswomen and men are influential actors and have an important role to play within society.

As a UK-based development NGO, we have worked to help shape the current legal framework for businesses, including advocating for the Bribery Act, for changes to the Companies Act, and for statutory reporting requirements including Non-Financial Reporting and provisions within the Modern Slavery Act. In addition, we have experience of participating in a range of multi-stakeholder initiatives which support responsible business practices in the UK and abroad, for example the Ethical Trading Initiative, the Extractive Industries Transparency Initiative, the Open Government Partnership and the development of the UK National Action Plan on Business and Human Rights.

Drawing on Catholic Social Teaching, we look for practical ways to ensure that directors and senior managers take into account how their business models will impact on human dignity and the natural environment. Reforms to the corporate governance framework are needed in order to drive more responsible business practices and we welcome the opportunity to participate in this review by the Financial Reporting Council. We welcome the recognition that it is important to consider wider society and the FRC's emphasis on 'stakeholders, integrity, and corporate culture, diversity and how the overall governance of the company contributes to its long term success.' It will be important to monitor and evaluate the impact of the revised UK Corporate Governance Code and UK Stewardship Code to gauge whether they are delivering the scale of change needed.

### **Key messages:**

#### **Citizens are questioning the role that business is playing within society**

As the Prime Minister highlighted in her introduction to the 2017 Green Paper, "it is clear that in recent years the behaviour of the limited few has damaged the reputation of the many." Survey data indicate that public trust in business has declined and not just in the UK. The 2017 Edelman survey recorded trust in CEOs at an all-time low.<sup>1</sup>

The UK is a major centre for businesses in terms of companies registered here and listed on the London Stock Exchange. Investment decisions and corporate practices have a

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<sup>1</sup> <http://www.edelman.com/news/2017-edelman-trust-barometer-reveals-global-implosion/>

significant impact on people around the world, including many of the countries where CAFOD's partner organisations work. These impacts can be positive but they can also be negative, as recent examples of businesses involved in high-profile corruption, harmful impacts on the environment and health, tax avoidance and evasion and systemic low pay have illustrated.

Women and men within the private sector have themselves identified the need for far-reaching changes in policies and practices – evidenced by a range of initiatives including the B Team and Blueprint for Better Business. These initiatives are welcome however more action is needed to deliver significant changes and address the problems caused by poor performers. It is clear that many businesses are pursuing models which are not sustainable.

### **The private sector has a vital role to play in addressing climate change and delivering sustainable development**

*"We all know that it is not possible to sustain the present level of consumption in developed countries and wealthier sectors of society, where the habit of wasting and discarding has reach unprecedented levels. The exploitation of the planet has already exceeded acceptable limits and we still have not solved the problem of poverty."*

Pope Francis, Encyclical Letter Laudato Si on Care for our Common Home, Section 27.

In 2015 governments committed to address global poverty through the Sustainable Development Goals and take action to avoid catastrophic climate change under the Paris Agreement. This is the context in which businesses will be operating and sourcing from suppliers. The UK government envisages that private sector actors will play a key role in delivering these policy objectives, for example through the creation of quality jobs, innovation and investment to deliver inclusive growth<sup>2</sup>. However current narrow interpretations of enlightened shareholder value encourage businesses to pursue short-term gains and externalise costs to the environment and broader society. Time is running out. In this context, corporate governance reforms offer an effective way to incentivise longer term investment by businesses across the board and support behaviours which respect the environment and human rights.

### **There is a need for more fundamental changes to company law to drive more responsible behaviour by businesses**

While multi-stakeholder initiatives and business-led campaigns can help drive positive change, our first-hand experience within initiatives such as ETI and EITI have given us a clearer picture of the limitations of these kind of approaches, as well as their strengths. The scale of the problem outlined above shows that fundamental changes to corporate governance are also needed. This should include legal changes to Section 172 of the Companies Act which will drive more businesses to adopt sustainable and inclusive business models. So while we welcome the reforms proposed by the FRC to the Corporate Governance and Stewardship Codes, in our view they represent a first step in delivering change.

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<sup>2</sup> DFID Economic Development Strategy: prosperity, poverty and meeting global challenges, January 2017

## **Responses to specific questions in the Consultation document:**

### **Corporate Governance Code**

#### **Q2. Do you have any comments on the revised Guidance?**

- We welcome the recognition in the proposed revisions to the code that it is important to consider wider society and the FRC's emphasis on 'stakeholders, integrity, and corporate culture, diversity and how the overall governance of the company contributes to its long term success.' It is important that the FRC reflects this interpretation more consistently in the Guidance so that Directors better understand what this means in practice.
- It is helpful to include Section 172 of the Companies Act 2006 as Figure 1 in the Guidance, however, the accompanying text places too great a focus on "generating and preserving value for shareholders for the long-term." This paragraph needs to be re-worded to reflect the Directors' duty to promote the long-term success of the company as a means to benefit its members.

#### **Q3. Do you agree that the proposed methods in provision 3 are sufficient to achieve meaningful engagement?**

- Catholic Social Teaching is clear that companies do not exist in isolation from society and we agree that companies need to do more to take into account the views of wider stakeholders, including the workforce. In our view, the three methods proposed in the consultation for achieving meaningful engagement in practice are not sufficient.
- The role of trades unions should be explicitly mentioned as one of the methods to achieve this goal. CAFOD supports the trade union proposals for worker representation on company boards. This is an established way of working in a number of other European states and the TUC has developed models for how this could work in practice in the UK.<sup>3</sup> It is concerning that other methods of workforce engagement are cited in provision 3 and the Guidance but union representatives are omitted. Both the Code and the Guidance should be amended to address this point. This will also help Directors in practical ways to meet other objectives set out in the code, e.g. monitoring corporate culture, making the most of our internal capabilities, looking for evidence etc.

#### **Q4. Do you consider that we should include more specific reference to the UN SDGs or other NGO principles, either in the Code or in the Guidance?**

- CAFOD supports including more explicit reference to the UN Sustainable Development Goals and the 2030 Agenda for Sustainable Development, of which they form an integral part, in the Corporate Governance Code. It would be helpful for this reference to be explained in more detail in the Guidance, with signposting to details of the 17 SDGs and 169 corresponding targets, as well as some of the key transformational principles of Agenda 2030 such as Leave No One Behind, deepening citizen participation, tackling inequality and taking a joined-up approach to environment and development.
- It is important to note that the UN SDGs have been agreed by states and as such represent a global consensus for development until 2030. In the experience of our partner organisations, they are already being used by governments at national level to inform policy-making. The SDGs provide a useful over-arching international framework which brings together environmental, governance, human rights and broader social issues. As such they will be helpful for Directors to consider the long-term sustainability of their business model as well as impacts on wider society

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<sup>3</sup> See for example: TUC 'ALL ABOARD - Making worker representation on company boards a reality', October 2016

- Businesses should respect human rights and ensure that they do no harm as an essential part of their support for the SDGs. In his letter on the Sustainable Development Goals and the UN Guiding Principles, former UN Special Rapporteur on Business and Human Rights Professor John Ruggie has stated that the starting point for businesses who aim to benefit society is 'reducing negative impacts on people associated with their own business activities and value chains'.<sup>4</sup> In this respect the UN Guiding Principles on Business and Human Rights which the UK government committed to implement in 2011, should also be at least referenced in the Code because they set out the corporate responsibility to respect human rights in practical terms. Again, the Guidance can be used to provide links to the wide variety of tools and reports which have already been developed to help businesses carry out meaningful human rights due diligence and identify and address human rights risks associated with their operations and supply chains.

## **UK Stewardship Code Questions**

### **Q20. Are there elements of the revised UK Corporate Governance Code that we should mirror in the Stewardship Code?**

- Yes. We would like to see consistency in the Stewardship Code with the revised UK Corporate Governance Code. In practical terms this means making sure that the Stewardship Code reflects the positive changes that the FRC is proposing to the Corporate Governance Code regarding long-term success, emphasis on Section 172, company culture, benefit to society and reference to economic, social and governance issues, including human rights issues.

### **Q21. How could an investor's role in building a company's long-term success be further encouraged through the Stewardship Code? and**

### **Q22. Would it be appropriate to incorporate 'wider stakeholders' into the areas of suggested focus for monitoring and engagement by investors? Should the Stewardship Code more explicitly refer to ESG factors and broader social impact? If so, how should these be integrated and are there any specific areas of focus that should be addressed?**

- It is important that the Stewardship code is amended so that it supports the welcome emphasis placed in the revised Corporate Governance Code on the long-term success of the company and Directors' duties under Section 172.
- Environmental and social issues, including human rights issues, should be explicitly mentioned in both the Stewardship Code and the accompanying guidance. Otherwise there will be a mismatch between the expectations placed on investors in terms of stewardship and the obligations placed on Boards. It is important that Principle 1 sets out the purpose of stewardship in terms of broader benefit to society.

### **Q29. Should the Stewardship Code explicitly request that investors give considerations to company performance and reporting on adapting to climate change?**

- Yes, we think that this is needed, given the global nature of the threat of climate change and the impact that it will have on the long-term success of companies. This should be cited in the context of the wider consideration by investors of environmental issues.

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<sup>4</sup>Open letter from John G. Ruggie, 2016 available at:  
<https://www.shiftproject.org/resources/viewpoints/sustainable-development-goals-guiding-principles/>