BUSINESS IN THE COMMUNITY

THE PRINCE'S RESPONSIBLE BUSINESS NETWORK

Business in the Community's response to the FRC's consultation on the UK Corporate Governance Code

Business in the Community (BITC) exists to build healthy communities with successful businesses at their heart. BITC – the Prince's Responsible Business Network – is a business-led membership organisation made up of progressive businesses of all sizes who understand that the prosperity of business and society are mutually dependent.

In the spirit of being a responsible business, our members are signed up to:

- Being the best they can be in delivering social, environmental and economic sustainability across all areas of their business.
- Joining with other businesses to bring together their collective strength and be a force for good.

BITC sets a course for responsible business, using our Responsible Business Map to guide members on a journey of continuous improvement, working across the whole responsible business agenda, including Purpose & Values, Governance & Transparency, Policy Engagement, Good Work & Inclusive Growth and Diversity & Inclusion.

As such, we welcome the opportunity to respond to the FRC's consultation on the UK Corporate Governance Code, and are broadly supportive of the proposed revisions. Our responses here represent the views of BITC as a campaigning organisation rather than the views of our business members more widely, who have not been consulted as part of this process.

Consultation on the UK Corporate Governance Code

1. Do you have any concerns in relation to the proposed Code application date?
Business in the Community does not have an issue with the timing of the proposed Code application date.

2. Do you have any comments on the revised Guidance?
On paragraph 28 we suggest adding 'Directors also need to be able to articulate how they have sought the long-term views of stakeholders and how their decision-making balances short-term and long-term pressures.'

On paragraph 30 we suggest amending to: 'how the benefits in terms of the long-term success of the company outweigh any negative impacts to wider society and the environment...'.

On paragraph 35 we suggest adding the sentence 'Such engagement activities should be used to establish employee views that inform the board if they have an appropriate culture, a clear strategy and the purpose and values are being lived by employees'.

THE PRINCE'S CHARITIES

On paragraph 35 we suggest the guidance could be more explicit about what constitutes effective engagement. It is implicit in a number of suggestions made but perhaps worth spelling out e.g. demonstrating change as a result of 'listening' to employees.

3. Do you agree that the proposed methods in Provision 3 are sufficient to achieve meaningful engagement?
Business in the Community notes that Provision 3 describes responsibilities rather than methods, as such it does not give sufficient guidance to achieve meaningful engagement. We note that a range of methods are given in paragraph 35 of Appendix B - Revised Guidance on Board Effectiveness. It would be helpful if this was referred to in Provision 3.

Meaningful engagement may require transparency of the engagement process and transparency of the ways in which the workforce will receive feedback.

4. 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?
Business in the Community recommends adding that the board should understand the company's contribution to wider society in the context of the SDGs, and include this in the Strategic Report.

5. Do you agree that 20 per cent is 'significant' and that an update should be published no later than six months after the vote?
Business in the Community does not have a strong opinion on whether 20% or 6 months are the best figures but supports that what is proposed is a positive step and better than the current situation.

6. No response
7. No response
8. No response

9. Do you agree that the overall changes proposed in Section 3 of the revised Code will lead to more action to build diversity in the boardroom, in the executive pipeline and in the company as a whole?
We do agree that the overall changes proposed in section 3 of the revised Code will lead to more action to build diversity in the board room and in the executive pipeline and in the company as a whole. Building diversity in the executive pipeline is vital to ensure there is a pool of talent with the widest range of perspectives and experiences possible to take up roles as they become vacant. Recently research from McKinsey 'Delivering through Diversity – January 2018' with a large sample size - 1000 organisations - across international geographies demonstrated that companies can improve their financial returns when ensuring greater gender and racial diversity.
In particular, we are delighted to see the incorporation of social and ethnic backgrounds alongside gender (para 65).

The Government sponsored McGregor-Smith Review: Race in the workplace 2017 first three recommendations are calling on employers with more than 50 employees to collect and publish data on ethnicity of their workforces. The fourth recommendation proposes legislation so that employers are required to publish the ethnicity breakdown of their workforces by race and pay if there is no evidence of voluntary action.

The three main political party manifestos outlined commitments to take action to take forward the recommendations from the Sir John Parker Review into ethnicity on boards.

Business in the Community has been calling for amendments to include 'race' through its recommendations in Race at the Top 2014 and Race at Work 2015. We are running Race at Work 2018 from 21 February 2018 with the support from the Department for Energy and Industrial Strategy as the next phase of the government sponsored race in the workplace review.

10. Do you agree with extending the Hampton-Alexander recommendation beyond the FTSE 350? If not, please provide information relating to the potential costs and other burdens involved.
BITC is strongly in support of this proposal as it is an important step needed to increase the proportion of women in leadership positions/on boards.

There is compelling evidence that boards with a critical mass of women outperform those who are less diverse. Diverse boards also more effectively demonstrate governance best practices which we believe leads to long-term shareholder value. For instance, a recent study conducted by Cranfield University showed that having more women on boards' foster better debate and decision-making practices. While the number of women being appointed to FTSE 100 boards has increased, few women are fulfilling senior roles on those boards, thus extending this recommendation to non-FTSE companies would help to drive change and performance.

11. What are your views on encouraging companies to report on levels of ethnicity in executive pipelines? Please provide information relating to the practical implications, potential costs and other burdens involved, and to which companies it should apply.
We think it would be sensible for the code to align with the recommendations from the McGregor-Smith Review: Race in the Workplace.

i) Published, aspirational targets: Listed companies and all businesses and public bodies with more than 50 employees should publish five-year aspirational targets and report against these annually.
ii) Publicly available data: Listed companies and all businesses and public bodies with more than 50 employees should publish a breakdown of employees by race and pay band.
iii) Encourage employees to disclose: All employers should take positive action to improve reporting rates amongst their workforce, explaining why supplying data will improve diversity and the business as a whole.

There will be costs to the organisations to implement the changes, processes and technology required for effective monitoring of the pipeline. However, a key finding from the review of race in the workplace is that there is a potential £24bn PA economic boost and 1.3% GDP to the UK economy if employers improve performance on race and ethnicity.

FTSE 100 companies that Business in the Community work with including BT, Barclays, HSBC, National Grid, Lloyds Banking Group and Sainsbury's who have a long history of collecting data on ethnicity. This provides a pool of organisations who can share some of their expertise and insight with the wider network of FTSE organisations.

12. No Response
13. No Response

14. **Do you agree with the wider remit for the remuneration committee and what are your views on the most effective way to discharge this new responsibility, and how might this operate in practice?**

We welcome the increased emphasis on employee engagement and pay and incentives across all employees not just those at the highest pay levels.

However the reference to wider workforce policies is quite vague and would benefit from more guidance and detail in practice. Business in the Community agrees that you may need to delegate to other committees where they exist, such as CR/ sustainability/ people committees, and believe that this could give more scope for employee voice and representation. The remuneration committee or board is a challenging environment for an employee rep to be optimal for their time and effort and we believe that the formal involvement of a more specific committee/ forum and role could enhance the experience and output for all involved. We agree that this is all guidance as it may well work in some cases.

Business in the Community would like to see companies with a significant proportion of low paid roles do more to understand the experience of work for lowest paid staff and forge plans to improve the quality and experience of work for those employees. Business in the Community would suggest a starting point for this is better collection and reporting of workforce data at different pay levels.
Business in the Community believes that for many industries they should ensure the committee has allocated responsibility for/ considered the pay and conditions of agency, contract and employees at other top tier supply chain partners and the role of the contracting terms of the company in use of those contracts and implications on pay and conditions.

15. Can you suggest other ways in which the Code could support executive remuneration that drives long-term sustainable performance?
Business in the Community believes there should be increased transparency around remuneration packages and how they work in the short and the long term. Clear information around what value creation constitutes for the business, including objectives and targets (financial and non-financial), and how remuneration is linked to success and failure to achieve such objectives and targets is necessary.

In addition, we believe there should be better information on pay ratios. Finally, we believe remuneration should match the individual’s competencies and experience as well as reviewed against the industry benchmark.

16. Do you think the changes proposed will give meaningful impetus to boards in exercising discretion?
More guidance is required to what is meant by 'actual performance', particularly around non-financial objectives and targets and how to balance compensation when financial targets are achieved in detriment of non-financial ones or vice versa.

Consultation on the UK Stewardship Code

17. Should the Stewardship Code be more explicit about the expectations of those investing directly or indirectly and those advising them? Would separate codes or enhanced separate guidance for different categories of the investment chain help drive best practice?
The stewardship code should be more explicit about the expectations of those investing directly or indirectly and those advising then.

Business in the Community considers this should be done through the provision of enhanced separate guidance rather than creating separate codes for different signatory categories.

Having one code will ensure all players in the chain should adopt the same principles, and the guidance can set the parameters for levels of reporting according to the signatories' role and position within the investment chain.

18. No Response
19. No Response

20. Are there elements of the revised UK Corporate Governance Code that we should mirror in the Stewardship Code?
The code can offer best practice against signatories who should 'comply or explain' in relation to reporting practices, rather than internal structures or roles.
BITC suggests that the stewardship code could:
- Remind companies of the importance of aligning purpose, strategy and values
- Integrate ESG risks and opportunities into the traditional financial analysis and ultimately investment decisions.
- Ask companies to consider the impacts on wider stakeholders
- Emphasise the importance of 2-way dialogue with investees, investors and regulators.
- Suggest a course of action if companies are not complying with the corporate governance code.
- Voting should be in support of the code.

21. How could an investor's role in building a company's long-term success be further encouraged through the Stewardship Code?
Business in the Community considers the code should highlight that the fiduciary duty of investors goes beyond maximising financial return and also includes safeguarding the economic, environmental and social landscape.

Investors should be encouraged to move from passive to active management, where possible, and advocate for long term value creation among their investees.

The code should also ask investors to report on the timescale of their investments and engagements. At the moment there is no mention of any type of timescales or what it constitutes long term.
Business in the Community suggests that the word 'value' is replaced by 'long term value', and that in their policy on discharging their responsibilities, Institutional Investors must indicate the time horizons for which they are considering that their stewardship responsibilities apply.

Investors should explain and report how they integrate ESG issues and future trends that could affect their investments into their investment decisions. This should include any framework they use to analyse risk and opportunity and the different strategies they use to implement such framework (e.g. best in class, exclusions, screening, ESG integration, or others). This should also incorporate how their stewardship policy evaluates material ESG issues and future trends that could affect their investments.

There should also be an evaluation of risks and opportunities including environmental and social ones.

22. 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?

Business in the Community does not consider investors themselves should be expected to engage with wider stakeholders, they may not have the knowledge/ expertise/ capacity.

There is an opportunity in Principle 3 to introduce the following:
- Satisfy themselves that the company has a robust materiality assessment covering environmental, social and governance issues and that they are engaging constructively with key stakeholders.
- Satisfy themselves that the company is paying due attention to the Sustainable Development Goals.
- Understand the wider risks and opportunities that ESG factors present to current and future investments, beyond maximising financial return.

23. How can the Stewardship Code encourage reporting on the way in which stewardship activities have been carried out? Are there ways in which the FRC or others could encourage this reporting, even if the encouragement falls outside of the Stewardship Code?
Investors should report on company engagement and where possible how this engagement has helped to create long term value (financial, social and environmental).

They should also report on the impact of their engagement and stewardship policy.

Finally, they should report on how their full portfolio is contributing/performing to the SDGs or their value creation framework of choice.

24. How could the Stewardship Code take account of some investors' wider view of responsible investment?
This could be addressed by providing separate guidance to the code. See response to Q18

25. No Response
26. No Response
27. No Response

28. Should board and executive pipeline diversity be included as an explicit expectation of investor engagement?
Business in the Community propose that Board and Executive pipeline diversity should be included as an explicit expectation of investor engagement.

The McGregor-Smith Review: Race in the workplace recommendation 25 makes explicit reference to institutional funds with holdings to FTSE companies to ask for their policies on diversity on inclusion. Explicit reference to BAME individuals represented across the employee base is mentioned and that would include effective policies and actions to increase the diversity of the talent pipeline to executive levels where there is a lack of representation.

Please see the recommendation 25.

With regard to the request for diversity policies, the Government should write to all institutional funds who have holdings in FTSE companies and ask them for their policies on diversity and inclusion and how they ensure as owners of companies that the representation of BME individuals is considered across the employee base of the companies where they hold investments.

29. Should the Stewardship Code explicitly request that investors give consideration to company performance and reporting on adapting to climate change?
Climate change will affect all businesses, directly or indirectly, with an estimated $2.5tn of financial assets at risk. Many businesses have been slow to respond to the threat. We see it of critical importance that where possible, levers and nudges are used to drive action on the issue, so we recommend that Investors are encouraged to review companies' performance on climate change adaptation. This should go beyond purely mitigation measures (e.g. energy efficiency).

30. No Response

31. Should the Stewardship Code require asset managers to disclose a fund's purpose and its specific approach to stewardship, and report against these approaches at a fund level? How might this best be achieved?
Asset managers should be required to disclose how different funds work towards achieving the investor's stewardship policy in general, which could include reporting on the purpose of each fund. BITC, however, cannot comment at the moment on the practicalities and feasibility of reporting at fund level.