The Ecumenical Council for Corporate Responsibility (ECCR) response to
The Department for Business, Energy & Industrial Strategy
Corporate Governance Reform Green Paper - November 2016
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ECCR accepts the basic objectives of corporate governance outlined in the Green Paper. It shares the concerns of the public, many shareholders, and the Government about the way executive and Board pay has increased substantially faster than pay for other groups of workers and with no apparent correlation with better corporate performance. The primary responsibility for that lies with company Boards that have used the criteria of relativism to other executives in other companies, often advised by specialist consultants, with little regard to company performance and comparisons with other groups within the company. Depending on the comparison group chosen by the consultants this results in a ratchet effect, too often endorsed by remuneration committees composed of executives in other companies that use the same criteria. We do not believe that the proposals with regard to Remuneration (below) are likely to be carried through unless the membership of these committee is much more independent from the rest of the Board, and not composed of members of other Boards who will expect to be similarly rewarded when it comes to their turn.

ECCR thinks there will be considerable amounts of evidence along similar lines and does not wish to duplicate that.

The primary emphasis of ECCR's submission is on the use (or not) of the Stewardship Code and the importance of companies changing their culture to base planning on the UN Sustainable Development Goals and the goals agreed by the Government in the Paris COP talks. Too often fund managers and shareholders encourage a short term culture within company boards by focussing on the next quarter's results and the immediate returns to shareholders. What suffers is long-term planning, and reinvestment in creating a better business in five or ten years time, which is more in accordance with a broader sustainable structural framework. The object of good governance is to strengthen the procedures and practice associated with decision-making, performance and control, in order to ensure long-term compliance with a sustainable framework agreed by the Board. It must provide structures and satisfy expectations of accountability to shareholders and other stakeholders.

Central to good governance is a culture of integrity and stewardship designed to enhance the trust of all stakeholders in the company's activities. If the underlying culture is wrong, and Boards foster short-term money-making at the expense of customers, suppliers, employees, and the communities where businesses carry out their operations, then companies will repeatedly fail to manage risk, sustain performance and earn the trust of all stakeholders.

In 2006 ECCR published 'The Bench Marks: A User's Guide'. It was written to introduce and help people and organisations use the Bench Marks (developed by ECCR and others as principles for global corporate responsibility for measuring business performance) as a tool for assessing and reporting on company behaviour, the Guide was first presented at ECCR's Workshop on Churches, Civil Society, Multinational Companies and Corporate Responsibility in Central and Eastern Europe, October 2006, in Prague, Czech Republic.

Within the Bench Marks document there are a number of common themes and principles which can contribute to guiding the way businesses operate. These include the following:

- Companies have a responsibility to ensure that all aspects of their production cycle cause minimum harm to people and the environment.
- Responsible companies properly consult stakeholders before making final decisions about activities that affect them.

- Responsible companies employ comparable standards across all of their operations. They do not use lower legal requirements in host countries to avoid applying those that would be required at home.
- Effective corporate codes of conduct are drafted with input from those who will be affected by them and have to implement them.
- Clear lines of responsibility and accountability are necessary for companies to properly implement corporate responsibility policies and practices.
- Responsible companies have clear systems for monitoring their environmental and social impacts and enable communities and civil society to contribute to this.
- Responsible companies provide publicly available and externally verified reports, giving comparable information about the social and environmental impacts of each of their operations.

We feel the above principles still hold good today.

Shareholders entrust the Board of a company to act as stewards of their investment. That means actively and responsibly managing the assets and employees entrusted to them, over the long term, in order to improve the returns on the investment over the long term and to hand on those resources to their successors in better condition than when they were charged with them. Getting this culture right seems to us to be central to good governance. Coming as we do from a background of Christian faith organisations we see companies, not only by what they produce and their impact on the environment, but also by how they contribute to sustainable communities and protect or undermine the dignity of the human person. We believe companies carry responsibility for the human and moral consequences of their economic decisions. We commend the parable of the talents (Matthew 25) as some of the more relevant management reading.

Good Stewardship by boards and investors is at the heart of the social contract that connects us all in the system – individual shareholders, pension schemes, insurance companies, fund managers and all the intermediaries who seem to prosper at present, regardless of the success of the companies and investors whose interests they are supposed to protect. It is the job of regulators and lawmakers to set a framework where long-term stewardship is central to company planning and is not undermined and punished by the many intermediaries whose annual incomes and bonuses are dependent only on the short-term results of companies. This conflict between the short-term interests of financial advisers, bankers, hedge-fund managers, stockbrokers, fund managers and all the other intermediaries who have flourished in the City in the last decade, and the long term interests of companies and their stakeholders is a real obstacle to good governance and needs attention. Consistently pursued good stewardship is critical to long-term value creation - intermediary goals need adjusting to recognise that, or their role in rating companies needs reducing.

One of the weaknesses with the structure of the Green Paper is that it fails to look beyond the national borders. Most of the large companies in the UK derive significant revenue and profits overseas. A key part of operating with integrity and building trust is therefore to behave honestly in the countries in which they operate. This is not just a question of not paying bribes. It is also requires paying a fair proportion of profits in tax in the countries from which those profits derive; of pro-active work to establish and inspect good working conditions, labour rights, safeguards against human trafficking, etc. so as to ensure that profits shared in London are not earned at the expense of workers on the ground; and of making sure that companies' activities in a country comply with the informed consent of the people of those countries – a particular problem for companies in the extractive sector and others who wish to operate in ways that may cause long-term damage to lands which have societal value for other reasons (religious or environmental). To aid responsible decision making in such situations it is important that lawmakers find and develop ways to place a more representative value on the exploitation of community assets. The damage done in land degradation and erosion can far outweigh the value of logs taken by a logging company; the climate effects of pollution or global warming may be far greater than the savings to a steel works or mine from not fitting filters or shutting old plants. Carbon pricing and higher charges for concessions payable to the country and the people affected are some ways of balancing the books for society at large. It is in long-term corporate interests that those mechanisms are supported and developed. The loss of tax revenues in developing countries is of far greater significance to them than the levels of executive pay in London. Good stewardship is about earning trust. Current levels of international contempt and mistrust for multinational companies is a direct result from the long term deficit of good and effective stewardship.

We are aware that this Green Paper on Corporate Governance is focussed on business behaviour and businesses' more immediate responsibility to shareholders and other stakeholders who have a direct interest in their financial success. But, as an organisation coming from a Faith direction, we also believe that there are wider questions which a company needs to address if it is to be seen to be acting with integrity. Companies cannot ignore that their actions will either assist or diminish the movement towards a fairer society. Nor can they limit the people they see as "stakeholders" to those with a financial interest in their business: many others will be affected by their actions, including those they employ, and, when we consider climate change, the future generations on this planet.

RESPONSES TO QUESTIONS

1. Do shareholders need stronger powers to improve their ability to hold companies to account on executive pay and performance? If so, which of the options mentioned in the Green Paper would you support? Are there other options that should be considered?
   We suspect that most of the powers to control executive pay and performance are already in existence, legally. The problems lie in the inability/unwillingness of shareholders to use those powers. There are two reasons for this: a) the powers are effectively controlled by intermediaries who themselves have a vested interest in high executive pay and performance bonuses on lax criteria, and b) a lack of understanding amongst shareholders (including investment committees of pension funds and other long-term investors) on how to use their powers. We suspect that amending the codes governing the conduct of intermediaries and investment committees to encourage a greater emphasis on good stewardship and long-term results would be the most effective way of bringing an end to excessive executive pay and bonuses. We favour Option 5 of strengthening the Financial Reporting Council Codes. We support amending the Companies Act 2006 to require brokers to offer underlying investors the option to opt-in to voting and wider information rights.
2. Does more need to be done to encourage institutional and retail investors to make full use of their existing and any new voting powers on pay? Do you support any of the options mentioned? Are there other ideas that should be considered?
   Yes. Existing Codes and voting procedures seem to give shareholders powers to limit excessive executive pay but those powers are not being used. We think the obstacle is the intermediaries (fund managers) who are themselves paid excessively and unjustifiably. How many investors have challenged the policy of their investment managers on supporting or challenging company pay policies? Investors should be encouraged to ask Fund Managers and Boards: a) what regard they have to reducing pay inequality within the company, b) what correlation there is between executive pay and performance over a five year period, c) what steps are taken to recover past payment of bonuses in circumstances where later results decline, d) what limits are in place to ensure that "golden parachutes" do not exceed six months basic pay? Fund managers should be encouraged to be more pro-active on limiting executive pay (noting the lack of any empirical evidence that higher executive pay improves corporate results or shareholder returns)

3. Do steps need to be taken to improve the effectiveness of remuneration committees, and their advisers, in particular to encourage them to engage more effectively with shareholder and employee views before developing pay policies? Do you support any of the options set out in the Green Paper? Are there any other options you want to suggest?
   Yes. We favour amendment of the reporting rules of the Financial Reporting Council to place greater emphasis on the Stewardship Code with specific encouragement to reduce remuneration differentials within the company.
4. Should a new pay ratio reporting requirement be introduced? If so, what form of reporting would be most useful? How can misleading interpretations and inappropriate comparisons (for example, between companies in different sectors) be avoided? Would other measures be more effective? Please give reasons for your answer.

We favour company reports having to give the ratios of executive pay (in bands for senior executives and Board Members) in relation to the average remuneration and the lowest paid within a company. Where possible this should be shown in comparison with other companies in the sector.

5. Should the existing, qualified requirements to disclose the performance targets that trigger annual bonus payments be strengthened? How could this be done without compromising commercial confidentiality? Do you support any of the options outlined in the Green Paper? Do you have any other suggestions?
   We see no reason why companies should not publish the structure of executive remuneration and bonus arrangements along with details of permitted variations. In particular the structures should disclose what percentage of the remuneration relates to improving corporate performance and what reductions will take place if performance declines or fails to meet targets. Inadequate transparency should be grounds for shareholder rejection of proposals and such rejection should be encouraged by fund managers.
6. How could long-term incentive plans be better aligned with the long-term interests of quoted companies and shareholders? Should holding periods be increased from a minimum of three to a minimum of five years for share options awarded to executives? Please give reasons for your answers.
   Where option schemes comprise part of the remuneration package, we favour a) base prices being an average of the past three years not simply the prevailing price at the start of the scheme chosen at a low point in a cycle, b)retention periods being extended to five years, c) triggers to reflect corporate performance in excess of market performance (ie options don't trigger just because markets have risen) d) awards to be repayable to the company (during the vesting period and for up to three years after vesting) if corporate performance falls significantly below market performance.
7. How can the way in which the interests of employees, customers and wider stakeholders are taken into account at board level in large UK companies be strengthened? Are there any existing examples of good practice that you would like to draw to our attention? Which, if any, of the options (or combination of options) described in the Green Paper would you support? Please explain your reasons.
   We favour amending Section 172 of the Companies Act 2006 to delete "for the benefit of its members as a whole" and in 1(b) adding "and pensioners". We feel that, for large companies in particular, boards should have regard to the impact of the company on all stakeholders, not just to the extent that such regard might increase shareholder returns. Thus, for example, where a company's activities are damaging the environment and that can only be ended at a cost to shareholders, the Board must consider making that change even if shareholders lose. Recent well publicised examples, like BHS, make it clear Boards must have regard to their pension obligations even at the expense of shareholders.
8. Which type of company do you think should be the focus for any steps to strengthen the stakeholder voice? Should there be an employee number or other size threshold?
   We favour governance rules applying to medium sized companies as well as large ones, whether publicly or privately owned. A combination of turnover and number of employees might be a guide eg companies with a turnover in excess of £50m and more than 100 employees.

9. How should reform be taken forward? Should a legislative, code-based or voluntary approach be used to drive change? Please explain your reasons, including any evidence on likely costs and benefits.
With the amendment to section 172 referred to earlier, we would favour reform through code-based changes with encouragement to develop the concept of stakeholder panels for any company in the FTSE 250 or equivalent sized non-quoted.
10. What is your view of the case for strengthening the corporate governance framework for the UK's largest, privately-held businesses? What do you see as the benefits for doing so? What are the risks to be considered? Are there any existing examples of good practice in privately-held businesses that you would like to draw to our attention?
We favour the extension of the corporate governance framework to apply to all large companies regardless of whether they are quoted or not. It should not be possible for companies to avoid public scrutiny or having to have regard to the wider stakeholder interests simply by going private. The obligation to have good governance in the interests of all stakeholders is the consequence of having the shield of limited liability.
11. If you think that the corporate governance framework should be strengthened for the largest privately-held businesses, which businesses should be in scope? Where should any size threshold be set?
Initially we favour the rules applying to any company of a size capable of inclusion in the FTSE250 if publicly quoted. This may need defining in a combination of turnover, profits and employee numbers. Over time we favour reducing the size thresholds through the extension of the Codes to medium size companies.
12. If you think that strengthening is needed how should this be achieved? Should legislation be used or would a voluntary approach be preferable? How could compliance be monitored?
We think some of the largest private companies would be very resistant to extending the Codes to cover them and therefore some statutory backing will be required. This could be limited to specifying the size of companies covered (capable of subsequent amendment by secondary legislation). Thereafter the Reporting Codes should be capable of ensuring compliance. Auditors should be required to check there has been compliance with the Codes, with sanction that non-compliance would be grounds for government proceedings to disqualify directors from service.
13. Should non-financial reporting requirements in the future be applied on the basis of a size threshold rather than based on the legal form of a business?
Yes.
14. Is the current corporate governance framework in the UK providing the right combination of high standards and low burdens? Apart from the issues addressed specifically in this Green Paper can you suggest any other improvements to the framework?
We favour amending the Codes to require companies to plan with due regard to the UN Sustainable Development Goals and the Paris Treaty on Climate Change.