

CORPORATE GOVERNANCE

DEPARTMENT FOR BUSINESS, ENERGY AND INDUSTRIAL STRATEGY (BEIS) GREEN PAPER

INTRODUCTION TO PRI

The United Nations-supported Principles for Responsible Investment (PRI) is the world's leading initiative on responsible investment. PRI is headquartered in London and supports 1600 signatories globally with £50 trillion in assets under management. There are 230 signatories to the PRI in the UK.

Responsible investment is an approach to investment that explicitly acknowledges the relevance to the investor of environmental, social and governance (ESG) factors, and the long-term health and stability of the market as a whole. It is driven by a growing recognition in the financial community that evaluation of ESG issues is a fundamental part of assessing portfolio value and investment performance.

There are key two areas of work undertaken by the PRI which inform our response to BEIS green paper on reforming corporate governance:

1. The PRI commissioned research and investor dialogue with companies on corporate governance issues, including executive pay.
2. The PRI has undertaken an in depth study of the UK market as part of our public policy programme. Stakeholders from across the UK's capital market contributed to our [UK Roadmap](#), which makes a series of recommendations to achieve full integration of ESG issues in the investment decision-making of UK investors.

SUMMARY RESPONSE

Executive pay: The green paper proposes additional rights for shareholders but also demonstrates that many investors do not use their existing rights in relation to executive pay. Strengthening stewardship is therefore crucial. The PRI recommends:

1. amendments to the Investment Regulations and FCA Code of Practice to establish a clear stewardship duty for all investors.
2. the Government signal that international investors should also comply with the Stewardship Code.
3. mandatory disclosure of fund manager voting records.
4. BEIS encourage companies to link executive remuneration with sustainable value creation.

Strengthening the employee, customer and wider stakeholder voice: The interests of stakeholders should be protected by Section 172 of the Companies Act. However, S.172 has not been successful in doing so. The PRI recommends that BEIS:

5. provide guidance to Directors on how they can demonstrate compliance with S.172.

6. establish a mechanism for stakeholders to raise concerns and seek remedy where their interests have not been included.

DETAILED RESPONSE

SHAREHOLDER INFLUENCE ON EXECUTIVE PAY

The corporate governance green paper asks whether shareholders need greater powers to help them hold companies to account. It also provides compelling evidence that many investors do not use their existing powers¹. In our view, the most effective way to address this is by strengthening long-term investor stewardship.

We welcome the FCA's recent comments on the future of UK Corporate Governance, recognising that strong shareholder rights and stewardship are, and will continue to be a core part of the UK's corporate governance framework².

To strengthen investor stewardship, two areas should be addressed:

- **Stewardship duty:** We recommend that the Investment Regulations and FCA codes are amended to establish a clear stewardship duty for UK investors. This could be reinforced through greater scrutiny of pension fund trustee practices by The Pensions Regulator.

Over half of the UK's stock market is owned by overseas investors, on whom such a duty would not be binding. The Government should also clearly signal that international investors in the UK should act in accordance with the UK's Stewardship Code, a practice adopted by other Codes around the world.

- **Disclosure of voting records:** From the options presented in the green paper, the PRI recommends greater disclosure of fund managers' voting records to their asset owner signatories. This is in line with market practice; of the PRI's UK fund manager signatories, 58% already provide public disclosure of their voting activities. In addition, institutional investors and fund managers should be encouraged to disclose rationale for voting decisions and in-house guidance. As well as supporting stronger implementation of the UK's Stewardship Code, this is also in line with recent developments in the EU's Shareholder Rights Directive (see [the PRI's briefing here](#)).

Executive pay should be aligned with performance and long-term strategy in order to protect and create value, but existing remuneration plans often do not promote sustainable value creation, which is in the interest of companies, their investors and their stakeholders. This lack of alignment is of concern for long-term investors. To that end, the PRI recommends that BEIS ensure that all companies:

- **Adopt a process:** Companies should be able to identify relevant ESG metrics and ensure these are a meaningful component of the overall remuneration framework.
- **Disclose:** Share information about the rationale, method and challenges faced when incorporating ESG metrics into executive pay.

For further analysis and recommendations, please see PRI's guide: [Integrating ESG issues into executive pay – a review of global utility and extractive companies](#).

¹ The paper states that 28% of shareholders do not make use of their voting rights. On average, FTSE 250 remuneration policies achieved 94% support over the 2013-16 period.

² <https://www.frc.org.uk/News-and-Events/FRC-Press/Press/2017/February/Speech-by-Sir-Win-Bischoff,-Chairman,-FRC-on-the-F.aspx>

INCREASING STAKEHOLDER VIEWS IN THE BOARDROOM

The UK Companies Act enshrines the concept of enlightened shareholder value in Section 172. The intent of S.172 was to encourage greater consideration of non-shareholder stakeholder views in the boardroom. By formalising pre-existing common law principles, it sought to provide clarity to Directors and stakeholders alike.

However, independent reviews³ and academic evidence⁴ consistently suggest that S.172 has not met this purpose. One key concern is that directors' deliberations are not transparent, meaning stakeholders are unable to identify if, and how, their interests have been considered.

Furthermore, 'a right without a remedy is worthless' - in the event that their interests have not been considered, non-shareholder stakeholders have no way to hold the company to account. Only shareholders can raise derivative claims against the company on behalf of non-shareholder stakeholders.

The PRI therefore recommends:

- **Guidance to Directors:** The Government provide further guidance on how Directors can demonstrate their compliance with S.172.
- **Enforcement mechanism:** The Government create a mechanism to allow stakeholders to raise complaints and seek remedy where their interests have been damaged.

CONTACT

The PRI is undertaking programmes of work relevant to this agenda. We would welcome the opportunity to provide further input as it develops. We also look forward to making further recommendations during the FCA's review of the Corporate Governance Code in 2017.

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³ [Evaluation Of The Companies Act 2006, Volume One](#). Independent review prepared for the department of business, innovation and skills (2010).

⁴ Eg. [The duty to promote the success of the company: is it fit for purpose?](#) (Professor Andrew Keay, 2010).