

Series of events on corporate governance

Organised by Cass Business School and Frank Bold

Conclusions

In Spring 2017, Cass Business School and Frank Bold hosted a series of discussion events on corporate governance aimed at charting the development of practice and policy towards a governance model fit for the challenges of the 21st century. The purpose of the series was to respond to the renewed interest among practitioners and policy-makers, including the UK Parliament, Government and the European Commission in modernising corporate governance. The series aimed to provide answers to the key questions raised in this debate. The organisers of the events have drawn the following conclusions from the speakers' remarks and subsequent discussions with the public.

Key principles of a new corporate governance model

22 March 2017

The first event focused on three key topics: executive pay, fiduciary duties and stakeholder engagement, that have been considered by the UK Parliament and UK Government in their respective ongoing inquiries into modernising corporate governance. The discussants equally examined how recent calls for a change in various aspects of the corporate governance system are connected to a broader rethink of governance models. The summary of the event is available [here](#).

- 1** How to act in the best interest of the company is difficult to ascertain, however it cannot be equated with maximising shareholder value, especially not in the short-term. In this respect, a vital function of corporate governance is to help build a corporate culture that promotes the long-term.
- 2** Section 172 of the UK Companies Act, which outlines directors' duties, obscures rather than clarifies the relationship between the interests of the company and of the members (shareholders). This problem can be addressed by simplifying the main definition of the obligation of directors to act in good faith by promoting the success of the company as an ongoing enterprise. The consideration of members (shareholders) can be moved to the list of factors considered by directors below this main definition.
- 3** Disclosure requirements should be aligned with the contents of directors' obligations under s. 172 of the UK Companies Act 2006 and guidance should be given outlining how directors should comply with these requirements.
- 4** From an institutional investor perspective, promoting the long-term success of the company requires moving beyond the shareholder versus stakeholder debate in order to recognise that in the long-term, their interests are aligned.
- 5** Integrated Reporting is an important way for amalgamating the different forms of capital being managed and for reporting on those capitals to the financial markets.
- 6** Long-term incentive plans (LTIPs) are not fit-for-purpose, as they are too complex and focused exclusively on financial metrics such as earnings per share. Evidence suggests that the way executives are rewarded does not have a positive impact on their performance.
- 7** Disclosure and shareholder votes have been the primary means of addressing executive remuneration but this approach has not only failed to fix the problems associated with executive pay, but this greater transparency may have aggravated the situation.
- 8** One way to re-balance executive pay towards the success of the company is to allow employees to express their views on executive compensation schemes through an appropriate consultative body, and, ideally, through representation on the remuneration committee.
- 9** Evidence suggests that employee' participation on boards encourages them to take a long-term approach to decision-making. There is no major legal or economic argument that would prevent employee representation on boards as long as their mandate as directors is embedded within the framework of the directors' overall responsibility to the company. Differing views were expressed at the event on whether it would be appropriate to impose a prescriptive legislation to this end.

Systemic risk and corporate governance

10 May 2017

The second event focused on how broad systemic risks from the environmental and social areas relate to corporate governance; how these medium and long-term risks can be assessed and reflected in business, investment, and insurance strategies; how regulators can best address these risks; and what relevant economic models are available to engage with these broad systemic risks. These topics are currently being considered by the EU High Level Expert Group on Sustainable Finance, which recommendations will feed into the EU Capital Markets Union initiative. Discussants examined both best practices and potential policy reforms. The summary of the event is available [here](#).

- 1** It is time to move towards an inclusive model for corporate governance that integrates multiple capitals in consideration of how businesses create value, taking into account inequality, productivity, human rights and the environment.
- 2** The UK Corporate Governance Code could better reflect Section 172 of the UK Companies Act, which outlines a number of issues that directors should have regard to, including dedicated stakeholders (employees, etc.), impact on communities and acting fairly between members of the company.
- 3** The regulatory strategy for corporate governance currently focuses on transparency and relies predominantly on shareholder' pressure but it should also consider managerial stewardship. It should give greater space to companies to retain and reinvest the profits they are making and consider strategies to react to systemic risks.
- 4** At a company level, managerial stewardship can be supported by a rotating system amongst top executives, which could promote accountability.
- 5** Risk appetite and mitigation strategies in regards to sustainability need to be set at the board level and should be integrated throughout the organisation - from the finance committee and managers to suppliers' audit.
- 6** Investors need to be forward-looking - they should describe their investment strategy and make recommendations on reporting to that effect. In doing so, investors' strategy should integrate and justify ESG considerations, such as carbon footprint, into every investment decision.
- 7** With respect of the engagement with investee companies, best practice for investors is to identify principal environmental and social risks facing every investee company in their portfolio and work to ensure that investee companies have skilled and appropriately diverse boards that are able to recognise and effectively handle potential risks (in particular black swan events).
- 8** The widespread use of benchmarks, index funds and other forms of passive investment, contributes to the allocation of assets to corporate and sovereign bonds, creating a kind of uniformity, which is a systemic risk in itself. This is an obstacle in promoting market diversity.
- 9** For systemic risks, such as climate change, a system-wide approach is needed. This means that broader metrics are necessary in corporate governance reporting than those currently used.
- 10** Investor engagement and divestment are necessary but insufficient on their own to prevent and mitigate environmental and societal risk. Further market reform is likely to be called for. The starting point for market reform is to clarify the purpose of our financial system.
- 11** Business schools are advised to integrate the UN Principles for Responsible Management Education in their curricula.

Corporate governance and reporting

7 June 2017

Building on the results of the previous two seminars on directors' duties and systemic risks, the third event of the series focused on best practice and the desired development of reporting and accounting practice and policy, a topic that has been raised in previous seminars as well as in all of the above-mentioned policy debates. The participants engaged with corporate purpose, fiduciary duties, long-term and ESG risks and related these to new and evolving legislative requirements that aim to support long-term oriented governance, such as the EU Non-Financial Reporting Directive. The summary of the event is available [here](#).

- 1** The purpose of corporate reporting is to have a record of pertinent information in respect of the business. Within corporate reporting, the annual report is the single most important statement, as it provides a platform for the board and senior management to express their views on the company. The annual report process brings together diverse corporate functions that articulate and define how value is created. In this way, the process creates the benefit of greater internal alignment and information sharing. The process further provides an opportunity for effective employee engagement through consultations and review of key questions, including those related to materiality.
- 2** Integrated reporting provides a mechanism that connects the existing reporting and accounting framework with a broader view on how businesses can create value, manage financial and non-financial capitals, and interact with their stakeholders. It allows companies to align their reporting with their purpose.
- 3** For the development of practice and regulation, integrated reporting can be used to clarify key issues, such as: the concept of materiality, sustainability and the interaction of reporting with corporate governance.
- 4** There is a scope within the legislation to clarify materiality with respect of specific issues, but it will be difficult to encompass all areas. The companies, and specifically, the boards have to be the ultimate arbiter of materiality.
- 5** With regards to integrating climate risks in companies' strategic considerations and financial projections:
 - The French regulatory framework for reporting, including Article 173 of the Law on Energy Transition and Green Growth (which requires both institutional investors and listed companies to consider the implications of climate change on their businesses), was considered to be an example of a well-functioning regulatory approach.
 - The recommendations of the Financial Stability Board Task Force on Climate Related Financial Disclosures suggest a potential method of reporting on climate risk and, as such, can be recommended for implementation in practice as well as for policy-making.
- 6** The regulators, such as FRC, should increase their efforts with respect to oversight and enforcement.
- 7** For investors, regulators and other stakeholders concerned with corporate performance, it is necessary to distinguish between disclosure and performance and go beyond disclosure criteria. It is useful to consider comprehensiveness and cohesiveness of the company's approach, as well as quality of risk assessment, including reliability of scenarios modelling. On the other hand, it is not that important if the company reports on every aspect of all available reporting frameworks.
- 8** From the perspective of a sustainability-oriented investor point of view, we should move away from distinguishing between sustainability for the company and sustainability for the society, and furthermore stop separating financial and ESG analysis. In this respect, the ESG perspective should not be limited to risk analysis.
- 9** The Sustainable Development Goals (SDGs) provide a good framework for understanding a company's shared value strategy.
- 10** Following the exponential rise of availability of information, quantitative sustainability analysis will play an increased role in the decision-making process of investors. This type of analysis must be based on clear admissible criteria, e.g. adherence to UN Global Compact and track record of not violating international environmental, human rights and anti-corruption standards.
- 11** Although it is not yet clear what links the data (i.e. where the causality lies), the results of the meta-analysis of ESG benchmarks anticipate risks of poor financial performance. Furthermore, the research is also clear in regards to the correlation between capital market and sustainability performance.

Organisers

The Cass events have been jointly hosted by Cass Business School and Frank Bold with support from Ecole des Mines and Hertfordshire Law School. Dr. Jeroen Veldman and Prof. Hugh Willmott run the Modern Corporation Project at Cass Business School and provide the academic basis for the Purpose of the Corporation Project, an open-source platform led by Frank Bold, a European purpose-driven law firm. The Project brings together leading experts and organisations interested in promoting the long-term health and sustainability of publicly listed corporations in the areas of policy-making and business management.

Between 2014 and 2016, Cass Business School and Frank Bold hosted a global series of roundtables on corporate governance with events held in Brussels, Breukelen (The Netherlands), London, New York, Oslo, Paris and Zurich. The results of the series of events are compiled in the [Corporate Governance for a Changing World](#) report.