Proposed Revision to the Stewardship Code

Submission to the Financial Reporting Council

Chartered Institute of Personnel and Development (CIPD)

April 2019

CIPD
Championing better work and working lives

Background

The CIPD is the professional body for HR and people development. The not-for-profit organisation champions better work and working lives and has been setting the benchmark for excellence in people and organisation development for more than 100 years. It has 150,000 members across the world, provides thought leadership through independent research on the world of work, and offers professional training and accreditation for those working in HR and learning and development.

Our membership base is wide, with 60% of our members working in private sector services and manufacturing, 33% working in the public sector and 7% in the not-for-profit sector. In addition, 76% of the FTSE 100 companies have CIPD members at director level.

Public policy at the CIPD draws on our extensive research and thought leadership, practical advice and guidance, along with the experience and expertise of our diverse membership, to inform and shape debate, government policy and legislation for the benefit of employees and employers, to improve best practice in the workplace, to promote high standards of work and to represent the interests of our members at the highest level.

CIPD
Championing better work and working lives

Our response

We have not responded to every question in the consultation document but have identified which individual question we are responding to.

Question 2: Do the principles set sufficiently high expectations of effective stewardship for all signatories of the Code?

Under *Section 2 Investment Approach*, the Code rightly highlights the principle that Signatories integrate stewardship with their investment approach and demonstrate how they take into account material ESG factors.

However, the Provisions under the top-line principles currently don't set out clearly enough how signatories achieve this, particularly in relation to workforce and human capital issues. CIPD research shows that many investors have little knowledge or understanding of the value and risk presented by an organisation's approach to workforce investment and management.[1] [2] This means they will often not be equipped to ask the right questions about how and why an organisation invests in its workforce and human capital management practices and how this will help it to deliver on its business strategy over the long-term.

Workforce issues differ fundamentally from climate change objectives, in that workforce investment is always directly linked to an organisation's ability to deliver on its business strategy and ambitions. Of course, this is not to claim that workforce issues are more important than other ESG issues such as climate change, for example, merely to emphasise that investors should view them very differently.

To make this clear, CIPD believes that the Provisions should require signatories to go further than just 'demonstrating how they take ESG issues into account' and require them to set out how different ESG issues are material to the business model of the organisation they are investing in and consequently their investment decision-making.

Investors need to demonstrate sufficient insight on key human capital management practices which will have significant implications for the future prospects of most organisations, such as corporate governance and culture; diversity and talent management; skills investment and utilisation; contingent workforce management; and workforce relations.

[1] CIPD. (2017) *The intangible workforce: do investors see the potential of people data?* Accessed online: https://www.cipd.co.uk/Images/do-investors-use-people-data-when-making-investment-decisions_tcm18-28747.pdf
[2] CIPD. (2015) *Human Capital Reporting: Investing for sustainable growth.* Accessed online: https://www.cipd.co.uk/Images/human-capital-reporting_2015-sustainable-growth_tcm18-9178.pdf

Question 4: How could the Guidance best support the Principles and Provisions? What else should be included?

For the guidance to investors to be effective it must actively drive them towards capturing evidence and demonstrating impact. This can only come by providing a clear outline of how signatories can demonstrate the impact of stewardship activities through qualitative and quantitative data. This should include case studies of how, through direct engagement on key issues, the investor has been able to exercise their stewardship responsibilities, and the outcomes of those activities. CIPD research with Warwick Business School has shown that investors who are actively engaging on workforce issues, such as those relating to leadership capability, are capturing data and using this information to inform their engagement with firms over the long-term.[3] Evidence in this form is valuable to the stakeholders of investors, such as the regulator, firms, and individuals in pension funds, who require more confidence that investments are being made against the principles of the stewardship signatory, and are generating impact over the long-term.

CIPD research has shown that there is growing interest among investors in workforce risks and opportunities, but there are barriers to the utilisation of data, including a lack of trust in its quality, low levels of understanding of the value of workforce data, and poor reporting standards.[4] These issues may in part be overcome if investors are supported, through the Stewardship Code and its guidance, to ask critical questions on key workforce issues. It is for this reason that the Code should look to emphasise the value of stewardship on workforce issues, and focus on promoting stewardship activities which demonstrate how investors are increasing their engagement with firms on workforce risks and opportunities.

Question 5: Do you support the proposed approach to introduce an annual Activities and Outcomes Report? If so, what should signatories be expected to include in the report to enable the FRC to identify stewardship effectiveness?

Annual activities and outcomes reporting should be implemented to ensure that stewardship signatories focus on driving engagement on key issues over the long-term and collect evidence for reporting purposes. To do this effectively activities and outcomes reporting should be ‘light-touch’ to avoid reporting burden and standardised in a simple format – with flexibility included for signatories to illustrate activities and outcomes in a way that is useful and meaningful for investor stakeholders. Key indicators to include in the activity and outcome reports should include measures relating to data quality assurance, stakeholder management and engagement, investor continuing professional development, and risk management. CIPD research shows that investors need support to engage on workforce issues in a holistic manner – much engagement appears to centre on issues

[3] CIPD. (2019) *The intangible workforce: investor perspectives on the workforce data.* Accessed online: https://www.cipd.co.uk/Images/investor-perspectives-on-workforce-data_tcm18-55499.pdf

[4] CIPD. (2019) *The intangible workforce: investor perspectives on the workforce data.* Accessed online: https://www.cipd.co.uk/Images/investor-perspectives-on-workforce-data_tcm18-55499.pdf

relating the management quality, or board diversity. [5] Instead investors need prompting to seek information on the wide-ranging people management practices that happen in firms today, and which are proven to be materially important over the long-term. As such activity and outcome reporting should be designed in such a way that prompts signatories to think holistically about these issues, and report progress over time.

Question 7: Do the proposed revisions to the Code and reporting requirements address the Kingman Review recommendations? Does the FRC require further powers to make the Code effective and, if so, what should those be?

CIPD supports both 'apply and explain' for the principles and 'comply or explain' for the provisions as set out in the Code. The key to the success of this approach though is the quality of explanations provided by investors where they have applied the principles of the Code or to explain where they have failed to comply with the Provisions of the Code. It is encouraging that the FRC has pledged to continue to monitor and assess stewardship disclosures against the Code, however the last published Tiering of Stewardship Code signatories by the FRC was in 2016. This showed that more than half of signatories were not categorised as providing 'a good quality and transparent description of their approach to stewardship and explanations of an alternative approach where necessary'. CIPD believes this audit of Code signatories should happen on an annual basis and that there should be greater transparency around those investors that don't meet the Tier One level of reporting against the Code's principles and provisions to encourage better practice in this area. An annual quality audit of Code signatories would also help ensure there is a better picture of whether the Stewardship Code is driving improvements in investor behaviour over time. There may be a case for FRC to 'name and shame' investors which fail to sign up or to meet the necessary standards required to comply with the Code principles and provisions. There could also be a kitemark developed for investors that meet the best standards of compliance with the Code.

Question 8: Do you agree that signatories should be required to disclose their organisational purpose, values, strategy and culture?

Signatories should be required to demonstrate how their investment practices align to their espoused purpose, values, strategy and culture. We broadly support a movement towards ensuring investors demonstrate their practices against these important elements, and agree that over-burden of reporting, such as applying such measures at the fund-level, should be avoided. We believe such changes in reporting practices can only influence behaviour over the long-term if they are designed with investors and their practice in mind. By demonstrating alignment against culture and values we think there would be various benefits – namely; it may expose where culture, values and behaviours are misaligned or even non-existent, it would call in to question internal validity for measures (e.g. at each

[5] CIPD. (2019) *The intangible workforce: investor perspectives on the workforce data.* Accessed online: https://www.cipd.co.uk/Images/investor-perspectives-on-workforce-data_tcm18-55499.pdf

level the same measures should operate, but not necessarily be reported by the investment house), and finally, would enable greater understanding of the culture of investors today, and how this is changing over the long-term.

Given that many investors are now asking questions about board and firm culture and behaviour, it follows that investors themselves should be held accountable against their own firms' behaviours, values and culture. As such, transparent reporting must be encouraged through the Code and mutual engagement actively sought by all actors, including the regulator, firms, and investors themselves.

CIPD
April 2019