

**CIPD Response to the Financial Reporting Council
Proposed Revisions to the Corporate Governance
Code**

Submission to the Financial Reporting Council

CIPD

Submission from the CIPD

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Contents

Contents	2
About the CIPD.....	2
Foreword.....	3
Introduction.....	4
A. Response to proposed revisions of the Corporate Governance Code	4
1. Leadership and purpose	4
2. Division of responsibilities	12
3. Composition, success and evaluation	12
4. Audit, risk and internal control.....	16
5. Executive remuneration and the remuneration committee.....	17
B. Response to the initial consultation on future direction of UK Stewardship Code	21
C. Bibliography.....	27

About the CIPD

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 140,000 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.

Foreword

For over 25 years now the Corporate Governance Code has been setting the tone for how UK business are being run, ensuring that ‘the balance between economic and social goals, and between individual and communal goals’ remains steady. Over time organisations have improved their governance practices by applying the clear directions of the Code, and directors shown a clearer route to effective practice. As a governing system the Code has enabled UK organisations to flourish. It is testament to its effectiveness that it has been exported the world over, leading to a proliferation of governance systems in different countries with many commonalities and similar principles.

Of course since its original development governance systems have been tested numerous times – perhaps most significantly during the global financial crash of 2007 but also with a range of corporate failures and scandals here in the UK. These events caused long-term damage to UK corporations and severely impacted the trust that society had in big-business. Once the generators and distributors of value, many were tainted as poorly managed and focused on the wrong set of goals, particularly in the short-term. Communities could no longer recognise the benefits corporations were meant to be generating.

As a result The Financial Reporting Council has taken the lead in addressing these concerns and re-evaluating the role of corporate governance. Their work on the Culture Coalition, and now this updated Corporate Governance Code, reflect a desire to take account of the multi-faceted, complex and dynamic environment in which organisations are now operating. Central to this is the pervasive concept of corporate culture – a concept which is now challenging organisations and their stakeholders in its immeasurability and complexity. With this new Code there are many important revisions that demonstrate and clearly articulate the importance of this concept to good business.

We welcome many of the changes the FRC propose to the Corporate Governance Code but we believe that regulation cannot be the only element to change. Now it is up to boards to take the lead in bringing about change which recognises the risks and opportunities they face, and should look to lead by example, particularly with regards to how they tackle the many challenges of the modern world of work. It is for this reason that the HR profession must play a key role in enabling boards to govern and lead organisations with their people in mind. Through their professional expertise, insights and understanding of current workforce issues, HR can enable boards and the organisations they lead to be successful in delivering value to their multiple stakeholders, including the workforce.

Peter Cheese

Chief Executive, CIPD

Introduction

To inform the CIPD's response to the FRC's Proposed Revisions to the Corporate Governance Code, we have undertaken two focus groups and several telephone interviews with senior HR professionals from our membership. We have included some quotes and vignettes from these conversations to illustrate our points, where appropriate.

We have also grouped two questions into one answer on some occasions, but have identified where this is the case.

Our response

A. Response to proposed revisions of the Corporate Governance Code

Q1. Do you have any concerns in relation to the proposed Code application date?

CIPD has no concerns related to the Code application date.

Q2. Do you have any comments on the revised Guidance?

1. Leadership and purpose

The revised Code includes references to the board's responsibility for considering the needs and views of a wider range of stakeholders. We welcome this change, and recommend that this includes understanding both the views of the workforce (employee voice), as well as understanding the expectations and norms of the wider society with regard to company practice.

- Employee voice is the means by which employees communicate their views to their employer. It's the main way employees can influence matters that affect them at work. For employers, effective voice contributes toward innovation, productivity and business improvement. For employees, it often results in increased job satisfaction, greater influence and better opportunities for development. The proposed methods in **Provision 3** offer a useful starting block from which organisations can define an effective, engaging and useful engagement method with employees. As **Provision 3** highlights it is critical that boards have insights from the workforce on workforce issues, and that employees are provided with the mechanisms and support to share their perspectives.

'HR should be in all conversations about setting corporate culture and behaviours, but the conversation should be with management, not just the board. HR should work with the rest of the executive committee to derive and answer the questions around culture, and the board should oversee it.' HR Director, Retail.

- Research has shown that whilst the awareness of employers of the importance of employee voice is increasing, there are still numerous barriers preventing better enablement and engagement of employees. The CIPD 2017 HR Outlook survey found that over half of organisations report they are taking steps to improve employee voice, but highlighted that employee attitudes including apathy, lack of engagement and fears around expressing their voice can act as barriers. It is therefore critical that leaders act to embed the principles and concepts of employee voice and ensuring visibility at board level. The mechanisms highlighted in **Provision 3** highlight some useful options for improving voice, each with their merits and potential drawbacks.

Forthcoming CIPD and University of Bath research (Cleaver, Zheltoukhova and Hope-Hailey 2018) aims to highlight ways for organisations to consider and be accountable for societal impact of their people practices. This concerns, for example, organisational decisions to adopt insecure employment contracts or management practices that serve business needs but are questioned by the wider society for their potential negative impact on the employee and the local community. While the Revised Code draws attention to a few specific topics of executive remuneration, equal pay and diversity – which we welcome – it does not put responsibility on Boards to interrogate how the incentives, policies and practices might impact the community and attract public scrutiny more broadly. Yet, lack of social legitimacy of business practices do impact reputation and trust in business and therefore the sustainability of the business model.

In order to strengthen the role of directors in considering wider societal responsibilities of business:

- The impact on reputation and wider acceptance of workforce practices should be included expressly as part of the business model conversation at board level.
- The revised Provisions and Guidance should include the following topic for boards: do our workforce policies and practices support or damage our social legitimacy?
- Directors should set the ‘tone at the top’ to empower management to mitigate this risk.

Q3. Do you agree that the proposed methods in Provision 3 are sufficient to achieve meaningful engagement?

The three methods for improving employee voice highlighted in provision 3 are stressed to be optional and fluid: organisations can decide which elements of the voice mechanisms best fit their organisation. Appendix B: Guidance on Board Effectiveness states that: “Provided the method chosen delivers meaningful, regular two-way dialogue and a means of listening to the workforce, the Code requirement will be met.” Therefore there is built in flexibility for companies to adopt methods of **best fit**. The three options suggested are summarised as follows:

1. Designated non-executive director

This option suggest responsibility for understanding and sharing employee perspectives to the board should reside with an appointed non-executive director, but evidence suggests that there are too few boards which incorporate HR directors at board level. For example, research by the Korn Ferry Institute found that there are no HR directors on the main board of FTSE100 companies in 2011 and, in some cases, the senior HR leader was not present at the executive board. While this may have changed to some degree, the likelihood is that the vast

majority of the main boards of FTSE companies will not have an executive director with an HR background. This lack of experience on the people side of business amongst main board executive directors is compounded by the fact that too few NEDs have an HR background. A survey by Harvey Nash (Harvey Nash, 2014) of more than 220 NEDs found that just 4% had an HR background compared to 26% with a finance background.

It is for this reason that we believe that when appointing NEDs in to this role. The following knowledge and experience should be sought:

- Previous leadership experience of People/HR function, for example experienced HR directors acting as NEDs, or experience of working with or acting on Remuneration Committees (with RemCo chairs).
- Understanding of people management, including knowledge of productivity, health and wellbeing, skills development, and diversity and inclusion.
- Proven track record of influencing senior decision making using workforce insights.
- Understanding of macro and micro contextual workforce issues relevant to their industry and workforce demographic.

'Effective NEDs understand HR issues, they understand HR data, and they also can see the broader picture. They're able to apply their knowledge and make interventions at the board. However, designating a NED to HR issues is a risk: you immediately limit their remit. Instead HR expertise should be built into the NED skills matrices'. Board Evaluator.

"I'm in favour of the non executive director option as the best way of ensuring employee voice and insight feeds into board level discussions. Good non execs are well placed to ask important questions and raise issues about the data. NEDs can challenge in a way that executive directors may not be able to because they see things from a different perspective - they are not 'smoking the same company dope", HRD and former NED and RemCo chair

As part of this role as employee champion, the NED should have ready access to HR insights and data from the HR function, and a formalised relationship with the HR/people director, responsible for the HR function. Given the extent of the remit proposed there are a number of drawbacks to NEDs with the enhanced employee champion role, namely:

- **Primary duties:** It is unclear in the proposals (Appendix B: Guidance on Board Effectiveness) how a NED fit their duties in an employee champion role alongside their other assigned duties, or whether the duties as employee champion would be their primary role. This could mean there may be conflicting interests between the responsibilities the NED holds.
- **Accountability:** In the designated role, it is unclear the accountabilities of the NED to the workforce, and how the workforce is to be engaged through the NED. For example, does this include accountabilities via the HR/workforce director, or are there other lines of accountability through the board and other directors of the business.
- **Whistleblowing:** To what extent are designated NEDs expected to uphold rules of transparency and anonymity in relation to workforce issues deemed important to the business. E.g. in cases of whistleblowing, should whistleblowing cases be escalated to the board via the NED, or to the NED only.

- **Credibility:** Many non-executive directors, because they are not full-time or permanent employees, won't have in-depth knowledge of material issues such as leadership styles and culture which may limit their effectiveness.
 - For this role to work effectively some interviewees believed that executive members of boards should look to strengthen their relationship with NEDs:

'The NED relationship with the rest of the board is often very tenuous. When they are well connected it is usually because of a big agenda, often remuneration, but there are certainly stories of NEDs who are withdrawn or even kept away from the CEO or Chairman. That of course must not happen as it prevents key discussions from taking place.' HR Director, Technology Firm

2. Appointed workforce director

A director appointed from the workforce would bring a different perspective to the board and could help improve the perception of the board's openness and engagement on workforce issues among staff. However an employee director would need significant training to be able to represent workforce views and to engage in board issues. They would also need to be able to draw on good quality data and insight from the wider workforce in different ways order to be able to add value and effectively represent the views of employees. Organisations will also need to identify an effective, fair and transparent method for appointing an employee director with an agreed process on nominations and election.

In addition there will need to be a clear understanding among the workforce of the types of issues that will be eligible for board discussion and clarity over the process for raising issues with the employee director to be discussed with the board. Just as importantly there will be need to be effective communication of the outcomes of relevant discussions material to the workforce to build trust and confidence that the employee director is representing workers effectively.

There are some key risks associated with the workers on boards model which require further exploration. For example, specific expertise and knowledge of the business may be required to be able to drive effective decision making, and for HR professionals we consulted this was a major barrier in elevating employees in to board level positions. Should an organisation implement this model, consideration is required as to the role, its profile and requirements, and the required skills for the post, otherwise:

'This is a real risk for boards – you essentially create a two tier board where not all discussions happen with the right people present. The worker on the board then does not get to engage in the debate they should be part of. This also goes against the need to shrink boards from 12-14 to 10 or less.' Board Evaluator.

'I fear the so-called worker-on-the-board could be tokenistic and unfair on the individual who takes the position. In our complex business it wouldn't work, particularly when they may have only two days a month exposure to the board and to the rest of the business.' HR director, Retail Organisation

“On a day to day basis it is much harder for an employee advisory committee or an employee director to engage with and integrate with the operation of the board than it is for a NED,” HRD and former NED and RemCo chair

3. Formal workforce advisory panel

The most complex of the options considered as part of enhancing workforce/employee voice on business issues, the formal workforce advisory panel offers a complex but potentially highly valuable mechanism for improving the extent to which employee perspectives are understood and explored by boards directly, as opposed via another party (e.g. Executive Director of the workforce, or appointed non-executive director). This “live link” to employees directly could be an important route to encouraging transparency and more considered conversations about the impact of the business model on the organisation’s workforce and its human capital.

‘We have a lab of millennials we use for consultations...for a significant change such as restructuring then having some effective forum for (employee) voice is useful.’ HR Director, Retail.

There are however a number of challenges regarding how a formal workforce advisory panel would work in practice, which are explored in more detail below:

- **Appointing employee representatives:** it is unclear how employees may be appointed onto the *formal workforce advisory panel* and the governance structures that would be needed. Criticism against such panels in the past have centred on the appointment of individuals and how they would be expected to carry out their duties as representatives as well as their working role and skills issues which may prevent employees from engaging effectively in board-level debate (e.g. corporate strategy). Instead, the workforce advisory panel operating as a separate entity but feeding into board debate would ensure that issues remain relevant and the board can remain confident that the appropriate expertise is available in each board committee and sub-committee.
- **Sub-committee alignment- where does the workforce advisory panel sit?:** issues of excessive executive remuneration may be countered by ensuring employees are consulted as part of remuneration procedure. Therefore, the workforce advisory panel could play a role in engaging with the remuneration committee at a governance level to agree levels of remuneration. This level of engagement could mean the workforce advisory panel could sit as a sub-committee of the remuneration committee. However, there may also be a case for aligning the workforce advisory panel with other temporary board structures (e.g. Risk Committee in the financial services, for example). As no evidence of good/best practice yet exists these issues need further exploration with research.
- **Integration with other forms of employee representation:** the application of voluntary employee representation structures such as the *formal workforce advisory panel*, led by management and without legal underpinning, risks weakening the role of trade unions as the bearer of employee interest representation (Müller & Hoffmann, 2001). Therefore, formalising structures through the Code would encourage the support and make clear the role of each structure within the employee voice system.

- **No receiving system:** Unless there is expertise on people and workforce issues at board level among executive or non-executive directors there is a danger this insight will not register or have real traction.

Given the strengths and weaknesses associated with the different approaches to enhancing employee voice, in the CIPD's view it is unlikely that any one of the three mechanisms identified in the Code will prove sufficient in isolation. A combination of two or all of these approaches is more likely to achieve the aims of the new Code.

Underlying and bolstering all of these forms of employee voice needs to be good data on the workforce. In large organisations, while anecdote and opinion is important, it will only tell part of the story. Human capital management (workforce) data on sickness absence, investment in training, job satisfaction, recruitment and turnover, for example, is needed to provide insight across the business and together with qualitative information can shine a light on issues such as culture or leadership style in different parts of the business.

This type of information is also needed if boards are to fulfil provision 4 of the Code which emphasises that boards should explain in annual reports how they have engaged with the workforce and other stakeholders and how their interests influenced board decision-making.

Whistleblowing

Provision 3 also makes clear that boards should ensure there are means for the workforce to raise concerns in confidence and, if they wish, anonymously.

CIPD believes that to ensure this happens, publicly listed companies should report regularly on the operation of their whistleblowing policies and practices, for example on how frequently they are used and the types of issue that have been raised. Unless there is regular evaluation and monitoring of the operation of whistleblowing policies, it is unlikely that boards will have sufficient insight on their policies to understand their effectiveness.

Companies should also consider reporting on near misses and the lessons learned to understand why issues around culture and risk are not raised at an early stage and the actions needed to ensure that staff at all levels feel free to report their concerns to prevent similar problems arising in the future.

Near miss reporting is encouraged by the Health and Safety Executive with some models suggesting that for every accident or incident there are approximately ninety near-misses. The approach has application beyond simply health and safety issues.

"The challenge with whistleblowing is that the core issue is about culture and values. People will only feel comfortable with raising an issue that might be uncomfortable or controversial where there is the right kind of leadership from the very top. This is ultimately about how we select leaders in the business – do we recruit them thinking about their role in leading and managing large numbers of people?" HRD, former NED and RemCo chair

Q4. 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?

CIPD believes there is merit in referencing the UN Sustainable Development Goal to 'Promote sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all'. This would provide encouragement for boards to consider the wider purpose of the organisation and to take a longer term view on how it delivers value beyond shareholders to other core stakeholders, including employees.

Section 172 Companies Act 2006 (Directors duties).

The FRC consultation document on the draft Code makes it clear that it will keep the exact wording of provision 4 of the Code under review pending the outcome of the Government's changes to Section 172 of the Companies Act 1996. As stated above, CIPD believes that in order for a board to explain how 'it has engaged with the workforce and how their interests have influenced the board's decision-making', it will need to demonstrate that it has core data on the workforce. To fulfil this requirement boards will need regular data on the total cost of workforce investment including contingent workforce, workforce diversity, investment in training and development per employee, information on annual recruitment and staff turnover costs and data on employee engagement, for example from staff surveys and data on formal disciplinary and grievances cases, and sickness absence.

a. Culture

'Corporate culture is one of the most important topics the executive team spend their time talking about. Putting something like culture into a Code misses the point of culture in some way because it's so complex and unique. You need the right measures and to put it at the heart of strategy; we invited our colleagues in to the meeting to share their perspectives. Conversations are key.' HRD, Retail

In our response to the BEIS Green Paper on Corporate Governance the CIPD and High Pay Centre called for organisations to establish **human capital sub-committees** at board level to consider human capital opportunities and risks, including workplace culture, on an ongoing basis. In our recommendations we stated that committees of this type are required by organisations if cultural issues are to be measured and managed appropriately. By working with boards, we believe such sub-committees could play an instrumental role in raising workforce issues and ensure that employee voice is recognised and utilised.

As part of our recommendation to establish **human capital sub-committees**, we suggested that panels be chaired by acting HR directors, who given their expertise and understanding of workforce issues, would be able to ensure that the committee considers relevant strategic workforce issues, and acts to consider important issues the workforce is facing. Including on these committees executive and NED members representing key functions, the **human capital sub-committee** could provide oversight and insight to the board on how human capital is being leveraged to deliver value through the business model and strategy.

The remit of the human capital sub-committee must, by its nature, be broad so to consider all types of human capital being utilised by the organisation; meaning that workers of different employment statuses (full and part-time contracts, fixed-term, agency, freelance and zero-hours contracts etc.) should be included. For organisations with high degrees of

off-shoring of staff, this may include gaining representation from firms providing such services. The development of such committees would mean that responsibilities for wider workforce issues could be re-allocated from remuneration committees, freeing them up to consider in detail remuneration and benefits.

Forthcoming CIPD and High Pay Centre Research: the human capital sub-committee

The CIPD is currently conducting research investigating how a human capital sub-committee may work in practice, to determine the key principles and guidelines and to explore key concepts the committee should consider.

Key questions which form part of the ongoing research include:

- What do you believe are the key principles that should guide the governance and operation of human capital sub-committees?
- Which aspects of the workforce should boards look to consult on via the human capital sub-committee model? E.g., should the human capital sub-committee focus on engagement, culture, learning and development?
- What do you believe are some of the risks associated with applying the human capital sub-committee model?
- To what extent should human capital sub-committees subsume or replace remuneration and nomination committees? What role should these committees have in relation to the human capital sub-committee?
- Who do you believe should chair and sit on the human capital sub-committee and what would the key desired outcomes be for their role?

The research will be conducted throughout 2018.

2. Division of responsibilities

a. Board composition

Q6. Do you agree with the removal of the exemption for companies below the FTSE 350 to have an independent board evaluation every three years? If not, please provide information relating to the potential costs and other burdens involved.

CIPD does not have a response to this particular question.

Q7. Do you agree that nine years, as applied to non-executive directors and chairs, is an appropriate time period to be considered independent?

CIPD does not have a response to this particular question.

Q8. Do you agree that it is not necessary to provide for a maximum period of tenure?

CIPD does not have a response to this particular question.

3. Composition, success and evaluation

We strongly support the explicit reference in Principle J for board appointments to be based on merit and objective criteria and to promote diversity of gender, social and ethnic backgrounds, cognitive and personal strengths.

Principle K highlights the need for regular evaluation of the board to consider the balance of skills, experience, independence and knowledge, its diversity and how effectively members work together to achieve objectives. CIPD believes that as part of this consideration of establishing the right balance of skills, experience and knowledge, there is a need for board expertise on the all the factors that drive value in organisations, including people management and development.

One of the reasons why employee voice and workforce matters are too often not given the attention they merit is that there is a lack of HR expertise within too many boards. Research by the Korn Ferry Institute found there were no HR directors on the main board of FTSE100 companies in 2011 and, in some cases, the senior HR leader did not even have a seat on the executive board. While this may have changed to some degree, the likelihood is that many main boards of FTSE companies will not have an executive director with an HR background. This lack of insight on the people side of business amongst main board executive directors is compounded by the fact that too few NEDs have an HR background. A survey by Harvey Nash (Harvey Nash, 2014) of more than 220 NEDs found that just 4% had an HR background compared to 26% with a finance background.

To address this CIPD believes that principle K should require that board evaluations should assess the level of functional expertise and stakeholder representation at board level. This would encourage board evaluations to actively consider the range of specialist insight required to drive value and manage risks across the business.

'Boards are only just waking up to their broader responsibilities...they now see they must look into succession, diversity, culture etc. Some boards are now thinking about how equipped they are to do that. They're now embracing the HR agenda.' Board Evaluator.

Q9. 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?

Taken together, the changes in the Code to promote and support efforts to build diversity in the board, in the executive pipeline and in the workforce more widely are positive and should significantly help focus more attention and action on this key issue. We believe that as well as there being an undeniable moral case for change, the diversity of ideas, perspective and ways of working afforded by people of different backgrounds and identities will benefit individuals, organisations, society and the economy.

The FRC consultation document on the Code rightly points out that there has been considerable progress in increasing gender diversity at main board level among FTSE 100 firms.

However almost all of this progress to-date has been as a result of more women being appointed to non-executive director positions, with little progress to date on improving gender diversity at executive director level on main boards. Progress in improving gender diversity among executive teams is slow, with women accounting for just 19.3% of executive team members among FTSE companies, an increase from 12% in 2011. Looking in more detail at the roles of women on FTSE100 boards, the Cranfield 2017 study found that, 'Whilst the percentage of women in NED roles has risen from 15% in 2007 to 33.3% in 2017, there has not been an accompanying rise in the number of women CEOs (currently 6%) or executive directorships (9.8%).' This matters because while non-executive directors play a crucial role in the governance of organisations, it is executive directors who are the visible leaders and role models in businesses.

In addition, Cranfield's Female FTSE Board Report 'Women on Boards: Back on Track?' found that, 'more women hold multiple directorships this year with 14.2% holding two and 9.7% holding three positions. The respective comparisons for men are 12.3% and 6.8%'.

Although we have seen a greater pace of change in relation to gender diversity, we haven't seen progress on ethnic diversity in practice to the extent or at the pace required. Sir John Parker's (2016, p.21) report into the ethnic diversity of UK boards found that, 'It is clear that the recent emphasis on gender diversity in the UK Boardroom has not benefited women of colour to the same extent as it has women who are not ethnic minorities. Of the appointments made following the Davies Review, a relatively small number of those Board positions have gone to women of colour.'

Provision 23 of the Code will help shine a light on these issues, in particular the recommendation that the annual report should include the gender balance of those in senior management and their direct reports.

We also support the recommendation that the annual report should describe the process in relation to appointments, the nomination's committee's approach to succession planning and how both will support building a diverse pipeline. Change needs to be driven by a focus on sustainability, not tokenism.

Therefore, the recommendation that the annual report should include what other actions have been taken to 'oversee the development of a diverse pipeline for future succession to board and senior appointments' is also positive. However it will be important that this provides sufficient detail on the HR and people management policies that have been put in place to boost diversity and inclusion across the workforce, for example flexible working policies, training for line managers and apprenticeship programmes, because it will be these sorts of practices that will lead to the retention and promotion of more diverse talent. These actions should be informed by an internal analysis of the blockers to the attraction and progression of female staff.

Q10. 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.

CIPD supports the idea that all companies, not simply those that are in the FTSE 350 should disclose in their annual reports, the gender balance on the executive committee and direct reports to the executive committee. This will provide meaningful data which can be tracked to help organisations assess whether attempts to improve gender equality are succeeding over time.

Q11. 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.

CIPD believes that all companies should be encouraged to improve their analysis and reporting on their workforce demographics to boost insight and understanding on overall levels of diversity and the HR and people management and development practices that will support greater inclusion and opportunity at all levels.

As well as the obvious moral case for equality of opportunity, there are clear talent implications. Around 14% of the UK working age population come from a black, Asian and minority ethnic (BAME) background, and by 2030, it is expected that the proportion will be closer to 20%. Without action to develop inclusive workplace cultures we face an underutilisation of talent through not enabling everyone to achieve their potential. And we should be further spurred on by the potential for change at a workplace level to influence wider societal change.

Businesses should be encouraged to report on the levels of ethnic diversity in executive pipelines and across the organisation as a whole. However, in reporting, businesses need to avoid making generalisations; 'BAME' is an often-used term in ethnicity reporting, however this term encompasses people from a wide range of backgrounds, cultures and traditions who face different barriers to entry and career progression. As with gender pay gap reporting, transparency can prompt action, but just reporting on the diversity of people in executive pipelines will fail to drive change in itself. There would also need to be a clear analysis on the reasons behind poor levels of representation and clear narrative reporting on the people management practices being developed to address these issues. Employers need to understand the factors keeping inequalities in place in different business contexts to be able to take informed action to address and remove them. Nonetheless, providing regular data on ethnic diversity will ensure there is an ongoing focus at board level on creating more inclusive organisations.

While recognising the need for progress in this area, it needs to be understood that many employers still don't collect even basic workforce data about who they employ, or do collect it but don't know how to access it or how to use it. The difficulty some organisations have had in providing accurate data to comply with the Gender Pay Gap Reporting (GPGR) regulations shows that many employers need to improve how they collect and analyse key workforce metrics. CIPD believes that organisations should be allowed a period of time to get to grips with the GPGR regulations before additional mandatory reporting requirements on pay gaps is extended to other protected characteristics.

HR has a central role to play in evidencing the need for change and where attention needs to be focused. Working across the business, HR can use their people insight to drive change at a much quicker pace than we are seeing at the moment. Business leaders and HR leaders need to ask themselves challenging questions such as 'could we analyse our employee survey findings by ethnicity (while still preserving employee anonymity)?' 'Do we look at how different groups are progressing, or where there may be glass ceilings?' And 'to what extent is insight on these matters shared across the business?'

It's important that organisations create the right environment where employees feel comfortable to disclose aspects of their personal characteristics. An inclusive culture where people trust both why they are being asked for this information and what it will be used for, is essential. Otherwise organisations may be limited on the data from which they can report, not reflecting the true make up of their workforce.

When reporting on multiple personal characteristics of the workforce, it's important to consider the interplay between these different personal characteristics. The nature of issues affecting an individual's progression at work is affected by the complex and interconnected nature of their identities. For example, does being a woman from an ethnic minority background mean you have more equal opportunities through progress on gender, but are still at a disadvantage at work because of being from a minority ethnic group? In short, we can't approach diversity and inclusion with entirely separate lenses. In addition, we propose we need lessons from gender pay gap reporting to inform the approach to both race and disability pay gap reporting, with the aspiration of creating one framework for reporting across different areas.

4. Audit, risk and internal control

a. Financial and business reporting

The inclusion of viability statements has gone some way to improve how organisations present their business model, planning and investment cycles, but as research has shown there are further requirements to demonstrate how risks are being mitigated against, and the time horizons over which risks are expected to play out. CIPD research has shown that for the UK FTSE 100 the quality of reporting of workforce issues has improved over time with those who are reporting engagement and wellbeing measures providing far beyond that which is required in statute. However there are aspects of workforce reporting which remain opaque, such as reporting on workforce training and development, and as such continue to prevent investors from using human capital information (CIPD, 2016b). As a result of this there are still areas of reporting which require improvement if investors are to gain the insights they need. Including enhanced reporting on workforce risk is one way through which organisations may be able to meet the needs of the revised **Provision 31** to report on how risks are assessed, the time period over which they are described, and how this time period was determined. The ideas included in **Provision 31** should further include reference to the workforce.

Financial and business reporting represents just one of the ways by which investors gain insight into the approach of organisations towards their workforce – for example, different investors seek information through investor reports, press and media releases, and importantly through meetings with senior management. Therefore workforce data which is produced in annual reports represents only part of the insights available to external stakeholders. Workforce insights should be linked across reporting mechanisms (online platforms, media outlets) to ensure that information is correct and coherent.

The workforce represents a principal risk and opportunity to be managed by boards, and as such improving the reporting of risk management approaches regarding workforce risk should be considered a key outcome from improving non-financial reporting. **Provision 29** should be improved to further emphasise the importance of reporting by the board of data and insights relating to the workforce, and narrative that describes how workforce risk and opportunity, particularly those relating to culture and behaviour, are being both mitigated against and managed on an ongoing basis. CIPD research has shown that investors use corporate reporting to understanding the quality of management in firms, and as such data relating to investment, development and performance of line managers and senior leaders, should be considered to be of high value and importance (CIPD, 2017a).

Further insights are required to ensure that the reporting of workforce risk and opportunity is adequate. However, drawing on current theory and practice there are a number of leading examples of organisations who are reporting their workforce information clearly and transparently, and are being recognised by investors for their clear reporting.

Q12. Do you agree with retaining the requirements included in the current Code, even though there is some duplication with the Listing Rules, the Disclosure and Transparency Rules or Companies Act?

And;

Q13. Do you support the removal to the Guidance of the requirement currently retained in C.3.3 of the current Code? If not, please give reasons.

b. Risk management and internal control

Ongoing assessment of workforce risk and opportunity is reliant on good quality data, delivered in a timely and actionable manner to boards, who are able to operationalise insights into business decisions. The assessment of risk management systems as described in **Provision 28** should include assurance that human capital / workforce data is valid, comprehensive and coherent (Rompho & Siengthai, 2012). Beyond health and safety human capital risk and opportunity is a relatively under-researched and under explored aspects of human resources management (Becker & Smidt, 2016). CIPD resource in partnership with CIMA and CMI found that human resources and finance professionals require standardised human capital measures (key performance indicators) and a clear language of reporting to better improve how human capital concepts, such as risk and opportunity, are both understood and communicated (CIPD, 2016a). Risk management systems should ensure that they include elements relating to the workforce, and incorporate standardised human capital measures, such as those represented in the Valuing your Talent framework (CIPD 2016a), and those in development by the British Standards Institute (BSI) and International Standards Organisation (ISO).

Workforce risks take various forms so are best reported through a mix of qualitative and quantitative measures. Given the complexity of human capital, CIPD research has illustrated how important accurate measurement of the workforce is through HR or human capital analytics, which incorporates both qualitative and quantitative data (CIPD, 2017b). Using narratives developed from human capital analytics the robust use of people data can help to describe important concepts relating to business performance and the execution of business strategy (CIPD 2017c). People data in its numerous arrangements should form the basis of clear and transparent risk reporting regarding the workforce. Given that the insights arising from human capital analytics include concepts connected to performance and business outcomes, the updated Corporate Governance Code should clearly articulate where and how workforce risk data should be reported, and the extent to which boards should look to this information in their decision making.

5. Executive remuneration and the remuneration committee

Q14. 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?

CIPD agrees that the remuneration committee (RemCo) should have a wider remit. The current focus on a handful of senior individuals can result in remuneration decisions that are divorced from business performance and the reward outcomes enjoyed by the rest of the workforce.

By covering the whole workforce, the RemCo reinforces the view that business success is a collective endeavour and this is reflected in its reward decisions. If staff believe that both their firm's reward decision making process and the outcomes of this process are fair, then this is likely to boost their: levels of financial well-being; trust in the organisation; and workplace productivity. By having company-wide responsibility for reward, the RemCo should be in a position to ensure that reward decisions across the organisation reflect the strategy, values and purpose of the enterprise.

For that reason, we do not think that the remuneration committee should delegate some of the oversight for workplace policies to other committees, unless it has good reason. The danger is that if this happened then oversight is considered in a variety of self-contained bubbles and there is no alignment between these bubbles.

In interviews with CIPD members we found agreement that RemCo should focus broader with some professionals doing this already in their organisations:

'It's academic that the issue of excessive pay is about (RemCo) not looking far enough into the workforce: most RemCo chairs look at the next level and seek alignment already...there is no doubt that RemCo and Boards have to take a system view across the organisation and their stakeholders.' HR Director, Retail

"Giving the RemCo a broader remit to consider wider workforce and people issues helps rebalance the debate away from focusing on purely financial matters. It helps look at the business through a people lens. In my view the RemCo should be renamed the People Committee. In my organisation's RemCo we discuss a whole range of wider workforce issues including broader pay strategy, the business transformation programme, and talent structures for example. I use it as a sounding board outside the main board meeting as you have a number of key non execs and execs in the room and can test people's thinking on key issues." HRD, former NED and RemCo chair.

If the organisation wishes to adopt an 'aero bar' structure where each bubble has operational oversight, then the RemCo should still retain the ultimate strategic responsibility in order to ensure that company remuneration and wider workforce policies are considered holistically. The CIPD has commissioned research that will explore how the RemCo can evolve to broaden its focus to wider people issues.

Our consultation with CIPD members highlights some important points on the role of Remco, and the challenges RemCo chairs currently face. For some, RemCo works well in its current form but skills should be high on the agenda for nomination committees appointing to RemCo:

'The current RemCo structure is perfectly functional for what it does. It varies by the calibre of people and the extent to which shareholders are engaged – both are important for it to work well. Remuneration committees need experienced professionals.' HR Director, Retail

We don't believe that there is one best practice approach when it comes to the most effective way of discharging this responsibility. It will depend on the various contexts in which an organisation operates and its evaluation of the possible approaches and consequences. It is up to the RemCo to demonstrate to stakeholders that they are discharging their new responsibilities in an effective way.

In practice, we would expect the RemCo to be able to show how it is promoting the financial well-being of all of its employees, such as through its pension provision or minimum hourly rate. We would also expect that the RemCo to ensure that reward decisions are evidence-based. If an employer wants to use performance-related pay, then it should be able to demonstrate how it has used the available evidence to make this decision. This evidence can be from outside of the organisation, such as research from an academic or a consultancy, as well as internal, looking at people measures such as employee turnover or performance.

The RemCo's ability to discharge its responsibility in practice will also depend on the quality of its members, who should be suitably qualified and experienced, have the appropriate attitudes, and reflect the diversity of the firm's workforce and its customer base. For instance, we support the suggestion that a RemCo chair will have served for at least 12 months on any remuneration committee before taking on this role. We expect that the RemCo to explore multiple perspectives when explaining how executive remuneration aligns with wider company pay policy and report on how this has been done.

Q15. Can you suggest other ways in which the Code could support executive remuneration that drives long-term sustainable performance?

CIPD analysis of the insights from behavioural science (Show me the money: the behavioural science of reward, 2015; *The power and pitfalls of executive reward: A behavioural perspective*, 2015) indicates that simply offering big incentives does not necessarily result in increased employee performance over the longer term. These insights suggest that the longer an individual has to wait for a reward the less they value it. If someone thinks that they only have limited influence over what needs to happen to get a pay out from a long-term incentive then they will value it less. Similarly, any incentive arrangement will be valued less if it consists of multiple targets and methods of assessment, or the pay-out is in a mix of shares and cash.

As a consequence, CEOs may in effect have to be compensated for complex and deferred incentive arrangement by increasing the size of the potential award. For this reason, we think the Code should encourage the parties involved in the process of CEO pay determination to question whether long-term incentive are appropriate in their contexts.

'As Chair of the Remuneration Committee I feel that RemCo is being asked to solve an impossible equation (with regards to executive pay): the issue goes much deeper in society than the RemCo. There are fundamental issues in society we have to address with regards to equality and wealth creation. I think we expect RemCo to solve the issue with a few people at the board, but the issue is far ranging.' HR Director, Retail.

The CIPD believes that many organisations and investors may get a better return on their compensation investment by abandoning their long-term incentives and focusing on simpler and more immediate awards that pay out in cash. We believe that pay shouldn't be used as a substitute to managing people, hoping that behaviours merit the pay outcomes. Instead, CEO reward and organisational success should be aligned through the performance management and development process.

Assessments of employee performance and development should be linked to how people create value for the organisation. Rather focusing on a narrow range of financial outcomes, investors and employers should adopt a broader assessment of employee contribution that

covers non-financial measures. Once they have a good understanding of how value is created within the firm, they can consider how value can be shared within the firm.

If employers are going to use medium- and long-term incentives then they should be structured to ensure exposure over a seven to 10 year time period and for three to five years after leaving the firm. The CEO should only be able to sell their shareholding on a phased rather than a block basis.

Another way of aligning CEO and company performance is through the executive pension arrangement, which should consist of a significant proportion of company shares, or having the provision to claw back some of the workplace pension in payment.

Q16. Do you think the changes proposed will give meaningful impetus to boards in exercising discretion?

We think that the Code should encourage boards to demonstrate how, when and why they have exercised discretion in determining pay decisions to their stakeholders. For example, how they have taken into account success in their bonus calculations that was due to factors external to the organisation, such as a fall in the value of sterling or a government policy initiative, which can boost earnings for some firms. What about discretion operating in the other way (if they've not got the money)?

In some instances, the ability of RemCos to exercise discretion in awarding incentives will be limited by contractual obligations. These should be identified and, if possible, amended. Moreover, there is also the issue of the length of time that a RemCo can issue discretion over.

However, we also believe that preventative action can also play a part. For instance, there should be an upper limit to any incentive or bonus scheme, for example a total remuneration figure. There is no hard and fast rule about where this maximum should be set, so the RemCo must engage with relevant stakeholders in order to come to a decision. We also believe that the RemCo should also set out the minimum salary level that an employee can receive at the organisation.

B. Response to the initial consultation on future direction of UK Stewardship Code

Effective stewardship by investors is a critical element of the UK economy as the “Other side” of the corporate governance coin. The Code’s main aim of enhancing the quality of engagement investors have with organisation remains important today as it did in 2012 when the Code was first introduced in its current format (Hill, 2017). Following the tiering exercise in 2016, the FRC has committed to continue to challenge investors to commit to their stewardship responsibilities and push to enhance the impact of the stewardship programme.

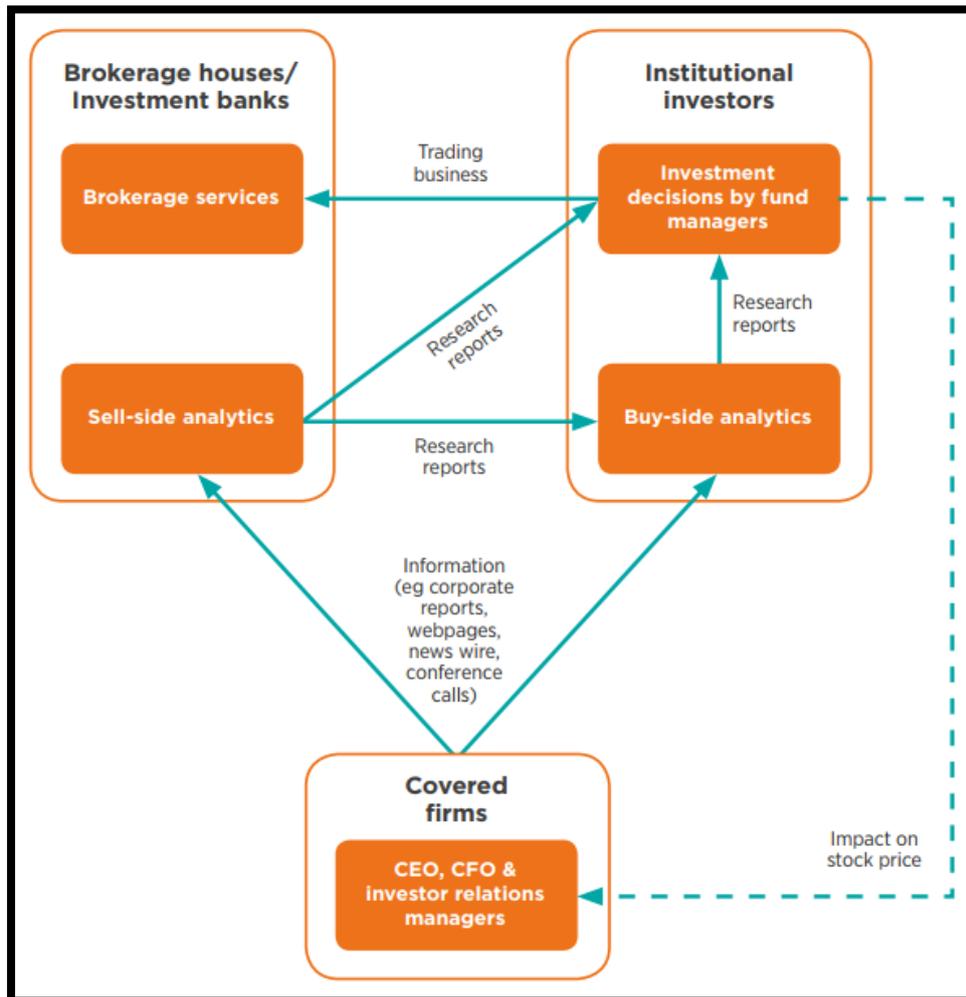
By encouraging institutional investors to report their compliance with the Code the FRC is able to gain a deeper understanding of the quality and quantity of engagement. For stakeholders of investors the benefit of compliance with the Stewardship Code is clear. For organisations the statements of compliance with the Stewardship Code offer insights into the approach and expectations of major shareholders. For those mandating asset managers it helps to inform choices, and for asset managers, it highlights the expectations of clients.

As global stewardship programmes have followed (Hill, 2017) the Stewardship Code is now at a place where it could be enhanced to play an even greater role in driving investment best practice if a greater emphasis was paid throughout to insights relating to intangible aspects of organisations, in particular the workforce. The present Code is geared towards enhancing engagement for the purposes of improving “long-term risk adjusted returns to shareholders”, a clear focus on shareholder primacy and therefore importance of the financial stakeholders. As effective stewards investors could enhance decision making to take account of if and how other stakeholders benefit from organisation success. As CIPD research with the Pensions and Investments Research Company has shown the drive by investors to ensure organisations become more sustainable and productive is becoming more apparent, and as such the Stewardship Code should reflect this evolving context/interest (CIPD, 2015). The positioning of the current stewardship Code which benefits “the ultimate providers of capital” does not adequately meet the needs of a shared-value economy from which all stakeholders of organisations prosper (CIPD, 2017e). As such this important positioning of the Stewardship Code should be addressed.

Q17. 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?

Investment chains can often be complex, with multiple stakeholders who at different times are required to offer insights and make critical decisions. Given that these chains are frequently complex and too often opaque means that it is difficult to understand the quality of investment decision making (CIPD, 2017d). CIPD research with Warwick Business School has shown that there are numerous elements in an investment chain each requiring different levels and types of insights, and as such requiring different types of data communication (via reporting, conference calls etc.) (see Figure 1 below).

Figure 1 – Information flows between organisations, securities analysts and investors (CIPD, 2017d based on Groysberg et al., 2008)



Adopting a principles based approach to applying the Stewardship Code may provide an overarching guide to the different signatory groups who are trying to apply the best practice models, and given the complexity of the system and variability within signatory groups it follows nuanced elements of the Code could be developed that apply directly to the signatory types. However, an overarching set of principles and high level elements that are common across the different “versions” of the Code would ensure that there is harmony and standardisation in its application.

Q18. Should the Stewardship Code focus on best practice expectations using a more traditional ‘comply or explain’ format? If so, are there any areas in which this would not be appropriate? How might we go about determining what best practice is?

Given the important relationship between the UK Corporate Governance Code and the Stewardship Code a similar philosophy should sit across them. As such, applying a ‘comply and explain’ or even an ‘apply and explain’ approach would benefit the multiple signatories who are keen to follow best practice and improve their practice. The current focus on disclosure and transparency does not enable detailed evaluation of the value and impact of stewardship practice, instead promoting signatories to err towards simple responses lacking detail. By promoting the ‘comply and explain’ model, practice is more likely to improve.

The UK Corporate Governance Code acts as a best practice document by outlining specific roles, structures and expectations with which those reporting against it are expected to 'comply or explain'. The Stewardship Code instead focuses on disclosure and transparency. A revised Stewardship Code could provide more specific expectations about best practice investor behaviour in a more traditional 'comply or explain' format.

a. Shareholder rights directive

Q19. Are there alternative ways in which the FRC could highlight best practice reporting other than the tiering exercise as it was undertaken in 2016?

The tiering exercise was a welcome approach to bringing in rigour and quality code statements, to promote best practice, and to engage those groups falling into tier 3 to improve their compliance with the principles and purpose of the Stewardship Code. We welcome continued frequent tiering of stewardship statements to assess changing quality, and to ensure that the adoption of best practices occurs throughout the investment chain.

Whilst the burden from increased numbers of signatories may make the process more challenging to complete, we believe it is fundamental that all signatories understand the outcome of tiering, and are given the opportunity to explore how to improve. Highlighting select groups of best practice, as opposed to tiering all signatories, may not provide enough of a push to signatories to improve practice. However, drawing out the qualities and aspects of best practice across all signatory groups and highlighting these to signatories and their stakeholders would be a welcome outcome and is more likely to increase their adoption.

CIPD research has described the complex relationships between the different elements of the investment chain (CIPD, 2017d). As such, this complexity may form a barrier to isolating best practice characteristics or behaviours. Therefore, CIPD recommends further work is conducted beyond the tiering exercise to isolate best practice and highlight their characteristics and impact. One methodology to do this could be through discussions between asset managers, institutional investors and organisations to uncover what good engagement practice looks like in practice – as such the FRC could act further as a convenor of discussions on improving practice, informed but not driven by tiering, to enable stakeholders to discuss and adopt new practice. The FRC Lab should continue to act in a research and innovation capacity to convene stakeholders throughout the investment ecosystem to ensure that stewardship practice is continually assessed and developed.

b. Amendments to the corporate governance Code

Q20. Are there elements of the revised UK Corporate Governance Code that we should mirror in the Stewardship Code?

The CIPD believes that the inclusion of guidance around workforce issues including culture and behaviours is an important update to the Corporate Governance Code which should be mirrored in the Stewardship Code. In their roles as stewards the investment community should encourage enhanced discussion on issues of culture and behaviour, and ensure that in their response companies adequately describe the quality of organisation culture and the action being taken to address issues as and when they arise.

By incorporating the concepts highlighted in **Principle A** that relate to culture, values and behaviours, the Stewardship Code could promote improved stewardship and encourage deeper dialogue as to the purpose and culture of organisations. As CIPD research has

recommended, there are various interventions boards can take to address cultural issues and develop new approaches, such as cultural diagnoses and transformation interventions (CIPD, 2016c). The Stewardship Code could promote better awareness amongst investors of the importance and value of culture to effective board delivery and therefore ensure investors actively seek information from organisations on how they are enabling effective and healthy corporate cultures to develop.

In addition to this there may be scope to enhance how the Stewardship Code relates to ongoing workforce issues, and the action of boards to address these concerns. The options highlighted in **provision 3** which relate to improved employee voice are mechanisms which the Stewardship Code should highlight – in particular how are investors satisfying themselves that boards are gathering the views of the workforce, investigating issues and opportunities, and taking appropriate action. The opportunity should be taken for changes to the UK Corporate Governance Code that enhance employee voice to be mirrored in the Stewardship Code in a suitable manner.

c. Long-term factors and other issues relating to investment

Q21. How could an investor's role in building a company's long-term success be further encouraged through the Stewardship Code?

And;

Q22. 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?

In addition to enhancing the perspective of organisation towards more long-term agendas, the Stewardship Code could include greater reference to the beneficiaries of long-term success to ensure investors act with multiple stakeholders in mind. CIPD research with Warwick University Business School has investigated differences between mainstream and Environmental, Social and Governance investors towards utilising human capital information and highlighted the differences between integration in traditional investing and ESG investment stewardship. The research points to little consistency in the application of ESG screens, and highlights the prominence of labour-related issues which are more commonly explored than direct human capital (knowledge, skills and abilities). However it is the ESG perspective in which long-term workforce related issues are more frequently considered, compared to mainstream investment approaches (CIPD, 2017d). As such, mainstream investors should be encouraged to incorporate ESG screening and principles into their processes.

Research by the Pensions and Lifetime Savings Association (PLSA) and Sustainalytics has shown that human capital is the most prominent ESG risk at the companies in which defined contribution pension funds invest and makes the case for improving ESG integration broadly due to its positive association with financial returns (PLSA, 2017). This research marries with the CIPD's own study which has highlighted that investors are keen to understand human capital issues, such as management quality, but are unable to access insights which are robust and have an impact on their decision making (CIPD, 2017a; CIPD, 2015). As such, there is compelling evidence which shows that ESG investments are weighted towards environmental and governance concerns, whilst social issues such as those related to the workforce and wider community stakeholders are considered less (Financial Times, 2017).

Therefore, within the Stewardship Code, more should be done to emphasises social issues, particularly those related to the workforce.

Forthcoming CIPD and University of Bath research (Cleaver, Zheltoukhova and Hope-Hailey 2018) aims to highlight ways for organisations to consider and be accountable for societal impact of their people practices. This concerns, for example, organisational decisions to adopt insecure employment contracts or management practices that serve business needs but are questioned by the wider society for their potential negative impact on the employee and the local community.

We suggest that when organisations get out of step with changes in societal norms relevant to workforce policies and practices, they attract public scrutiny which in turn could cause a reputational issue, increasing investment risk. Investors, therefore, should be encouraged to interrogate not only the quality and appropriateness of workforce practices in the context of a given business operating model, but also in the context of wider societal norms.

d. Asset classes

Q24. How could the Stewardship Code take account of some investors' wider view of responsible investment?

CIPD research has shown that the complexity of the investment chain means it is difficult for a 'one-size fits all' approach for the adoption of Stewardship Code principles, and that there are important differences between how mainstream and ESG investors make use of workforce/human capital information in their valuations and recommendations (CIPD, 2017a). As a result more nuanced approaches are needed for promoting stewardship behaviour to ensure different communities engage with the principles of the Code and act accordingly. One way to do this could be through emphasising principles which already exist for the responsible investment community, such as the UN Principles for Responsible Investment (UN PRI). The UN PRI includes six principles to guide effective investment with sustainability issues in mind and in particular principle 2: "*we will be active owners and incorporate ESG issues into our ownership policies and practices*" and principle 6: "*we will each report on our activities and progress towards implementing the principle*" reference the role of stewardship and its place in responsible investment practice. It is therefore important to ensure that wider investment perspectives are understood and reflected in the body of the Stewardship Code – and that by incorporating these different perspectives an ongoing discussion is enabled that explores these differences and understands its value and impact. Further work by the CIPD and Warwick Business School in 2018 will explore the impact of these different perspectives on how investors steward with workforce issues in mind.

e. Content elements of other codes

Q25. Are there elements of international stewardship codes that should be included in the Stewardship Code?

Since the UK Stewardship Code was introduced in 2012 there has been a proliferation of Stewardship Codes worldwide which build on the principles and concepts developed in the UK. Three types exist: (1) codes issued by regulators and quasi-regulators (e.g. UK, Japan, Denmark, Hong Kong), (2) Private sector industry (non-investor lead) e.g. South Korea, and (3) Investor-community lead (e.g. Australia, Canada and Italy). Research has shown that each typology has specific characteristics which differ according to the jurisdiction and context. For example it may be argued that the 2012 UK Stewardship Code emphasised effective risk control in a post-financial crisis economic environment, whilst the 2014

Japanese Stewardship Code focused on the “arresting declining profitability, unlocking value, and increasing investor returns” (Hill, 2017). This means that there are particular elements of international codes which are designed with jurisdiction needs in mind.

There are however elements of international Stewardship Codes which the UK Stewardship Code could adopt, in particular the greater emphasis on ESG issues found in some international standards [e.g. South Africa Code for Responsible Investing (CRISA) or International Corporate Governance Network’s Global Stewardship Principles] (Hill, 2017). These codes pay greater emphasis to ESG, whilst the UK code has been criticised for not explicitly referencing these concepts (see Hill, 2017; Howarth, 2017). In the CIPD’s view it is critical ESG perspectives which encourage understanding of human capital are emphasised in the UK Stewardship Code, given that it is through the ESG lens through which workforce issues such as corporate culture, skills and diversity & inclusion are picked up. These material issues are important for understanding performance (see CIPD, 2017b) and should be of material interest to investors – therefore learning from international approaches would enhance the quality of the code, and its ability to improve stewardship on workforce issues.

f. Diversity

Q28: Should board and executive pipeline diversity be included as an explicit expectation of investor engagement?

The Hampton-Alexander review highlighted that there is a need to address gender diversity at the leadership of FTSE organisations, particularly in the talent pipelines that feed the board’s top talent both internally and externally; in order to meet the 33% target of female to male ratio at the board, over 40% of all appointments to boards must go to women between 2017 and 2020 (BEIS, 2017). CIPD research backed up this issue of gender of executive directors, finding that that over three-quarters (77%) of FTSE 100 companies have no female directors, and only 6% of FTSE 100 CEOs are female (CIPD, 2017g). Evidence highlights that boards must enhance their ability and effort to attract and retain talent from a diverse set of backgrounds.

The approach of boards to diversity and inclusion is also important in demonstrating the values and principles of the firm. CIPD research has shown that black, Asian and minority ethnic (BAME) employees are more likely than white workers to say that career progression has failed to meet their expectations, and are also were more likely to state that seeing other people like them progressing would help boost their ambition in their careers (CIPD, 2017f). It is therefore important for boards to address these issues not only for the purposes of enhancing board capability, but also to demonstrate their principles and values towards diversity and inclusion to employees from disadvantaged and minority backgrounds.

Investors should engage with firms to enhance diversity and inclusion of talent pipelines particularly during the appointment, succession and evaluation of boards. The Stewardship Code should be updated to include mirroring references to the revised Corporate Governance Code which promotes greater engagement on talent pipeline issues. Best practice examples of investor stewardship and engagement on board diversity issues could highlight how continued engagement can promote positive change on D&I issues.

g. Purpose of stewardship

Q30: Should signatories to the Stewardship Code define the purpose of stewardship with respect to the role of their organisation and specific investment or other activities?

And;

Q31: 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?

Stakeholders of investors who are keen to understand stewardship practice would benefit from further information being provided given the complexity of the investment chain (CIPD 2017a). A description of the approach and role of stewardship by the signatory organisation would help to improve transparency and accountability, and foster best practice stewardship approaches to be more widely adopted.

CIPD research has highlighted that there is much that still needs to be understood about if and how investors utilise information human capital in their investment decision making process (CIPD 2017a). Research and insights could include benchmarking stewardship commitments across the investment ecosystem, and describing individual approaches to stewardship (e.g. its purpose, value, and outcomes to signatories). This would enable research and policy stakeholders (including by FRC Lab, and the academic community) to better understand the intentions and strategies of investment groups and how these are being followed through the investment process. Promoting asset managers to report stewardship commitments per fund would help to uncover if and how funds differ in their application of the concepts of stewardship, and could provide further useful data to improve application of the Code (e.g. if certain funds were commonly reporting stewardship commitments to tier 3, whilst others obtained tier 1).

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