Wildlife and Countryside Link response to the Corporate Governance Reform Green Paper

February 2017

Wildlife and Countryside Link (Link) brings together 45 voluntary organisations concerned with the conservation and protection of wildlife, countryside and the marine environment. Our members practise and advocate environmentally sensitive land management, and encourage respect for and enjoyment of natural landscapes and features, the historic and marine environment and biodiversity. Taken together our members have the support of over eight million people in the UK and manage over 750,000 hectares of land. This response is supported by the following six organisations:

- Buglife
- Butterfly Conservation
- Plantlife
- Salmon & Trout Conservation
- Wildlife Trusts
- Wildfowl and Wetland Trust

Summary

There is increasing recognition of the essential role that business can play in protecting and sustaining natural capital and the environment. Business must be aligned to environmental objectives if we are to meet the challenges and international commitments that face Government and society.

There is an international trend towards better environmental accounting and reporting in business and there have been several steps forward in the UK in recent years. However, progress is patchy and environmental considerations are absent from some key guidance and aspects of corporate Governance. Evidence suggests that improving corporate governance has very significant positive environmental outcomes and will be key to achieving the purposes established by the Treasury's Natural Capital Committee.

This consultation and the current political circumstances offer a great opportunity to develop environmental governance fit for this century. We identify a number of areas for improvement that could be developed for inclusion in the White Paper:

1) The appointment of non-executive directors with environmental expertise.
2) The inclusion of environmental considerations across existing guidance.
3) Joined up guidance on environmental.
4) Auditing of the environmental content of annual reports.
5) How pension schemes address long term and environmental issues.
6) The responsibility of company directors in relation to the environment.

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Introduction

Protecting and enhancing the UK's environment is a growing priority that requires determined and coordinated effort from government, civil society and businesses if we are to achieve the manifesto commitment to be the "first generation to leave our environment better than we found it".

A healthy and sustained environment relies on all the key actors acting in an aligned manner to achieve outcomes that benefit everyone. Complacent corporate governance fails to ensure that there is sufficient clarity of responsibility and transparency to secure good environmental outcomes, while bad corporate governance sets business against the best interests of society. Included within the aims of corporate governance should be the achievement of improved environmental performance for business and for the country as a whole.

We are disappointed that the Green Paper only dealt in passing with the environmental dimensions of governance functions. Given that BEIS brings together responsibilities for business, science, innovation, and climate change, this would be a great opportunity to accrue benefit from this join up. We hope that the White Paper will set out the next steps towards improving the environmental aspects of good governance.

1. Good environmental governance is good for business and the public

Environmental health and resources are key factors for most businesses; internally the availability and depletion of natural resources are central to the sustainability and financial viability of many businesses, while the effect of a business on external environmental factors can have significant repercussions for customers, clients and the public, and, via brand perception, the business itself.

A Defra sponsored study on the role of Environmental Management Systems in 2011 found that they delivered cost savings for the majority of SMEs in the study, with an annual average saving over 2 years of £4,875 per £m turnover. The costs of certifying and implementing the EMS were calculated at £1,362 per £m turnover[1].

The financial benefits of tracking, reporting and auditing the environmental footprints of businesses are being increasingly recognised. For instance the Companies Act 2006

[1] Hillary R and Burr P September 2011 Evidence-based Study into the Benefits of EMSs for SMEs By WYG Environment A research report completed for the Department for Environment, Food and Rural Affairs http://randd.defra.gov.uk/Default.aspx?Menu=Menu&Module=More&Location=None&ProjectID=16942&FromSearch=Y&Publisher=1&SearchText=EV0440&SortString=ProjectCode&SortOrder=Asc&Paging=10#Description

(Strategic Report and Directors' Reports) Regulations 2013 requires quoted companies to report on greenhouse gas (GHG) emissions for which they are responsible.

Incorporating environmental responsibility into governance measures improves environmental performance as well. A 2016 report by Lancaster University looked at the role of board expertise in environmental issues, measured by the presence of non-executive directors with previous experience in environmental issues. Emission data from FTSE 350 firms, showed that presence of environmentally experienced non-executive directors on boards reduced GHG emissions by c. 20%[2]. However, a minority of companies have environmental expertise on their boards and even when they do, it is not always sustained – in the Lancaster study 30% of companies with an environmentally experienced non-executive director did not have one three years later.

Benefits of good environmental governance stretch beyond cost savings and carbon reduction, the 2012 TEEB report states that:

> "The commitment to address Biodiversity and Ecosystem Services systematically starts at the level of corporate governance, the system by which any organisation's decisions are made and implemented. Biodiversity and ecosystem information systems thus need to be linked to overall business information management, as well as fitting into wider environmental management"[3].

In recent years there has been progress on businesses taking greater responsibility for their environmental assets and impacts, and a number of leading companies have put environmental factors high up their corporate priorities.

One example of best practice is Crown Estate a commercial business that consistently outperforms the market. Last year (2015/16) they delivered a profit of over £304 million to HM Treasury. Sustainable growth is central to their business resilience and underpins their competitive advantage. They have pioneered a Total Contribution approach since 2013. Total Contribution plays a vital role in providing them with a deeper understanding of the impact of their decisions on their capitals, and ultimately demonstrates the bigger contribution they make beyond their financial return:

- Total Contribution is a methodology which demonstrates the value the Crown Estate creates by measuring the impact of their activity on the capitals on which they depend

[2] Homroy S and Slechten A November 2016 Board Expertise, Networked Boards and Environmental Performance Department of Economics, Lancaster University, LA1 4YX https://www.researchgate.net/publication/310625325_Board_Expertise_Networked_Boards_and_Environmental_Performance

[3] TEEB (2012), The Economics of Ecosystems and Biodiversity in Business and Enterprise. Edited by Joshua Bishop. Earthscan, London and New York. http://www.teebweb.org/our-publications/teeb-study-reports/business-and-enterprise/

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- Financial resources; Physical resources; Natural resources; Their people; Their know-how; Their networks.

- Their approach combines smart business thinking with a long-term approach. They call it conscious commercialism.
- Total Contribution methodology provides them with information and insight on the effect of their actions, enhancing their decision-making and enabling them to report[4] the broader value of what they do. It plays a critical role in helping them to think in a wider, deeper and increasingly integrated way about the impact of their actions.

However, there remains much variability in both environmental reporting and the extent to which businesses are taking their environmental responsibilities seriously.

The Kay Review – commissioned by the Secretary of State for Business, Innovation and Skills and published in 2012 – undertook a detailed review of UK equity markets and their impact on the long-term performance and governance of UK quoted companies. Professor Kay listed firms which sacrificed safety, the environment and their reputations for immediate profits. He commented that:

> "many of the bad decisions described were supported or even encouraged by a majority of the company's shareholders"
>
> "Some pension fund trustees equated their fiduciary responsibilities with a narrow interpretation of the interests of their beneficiaries which focused on maximising financial returns over a short timescale and prevented the consideration of longer term factors which might impact on company performance, including questions of sustainability or environmental and social impact."[5]

Clearly there is considerable room for improvement, and this improvement will have to be made if society is to achieve its aim to halt and reverse environmental declines as set out in the UN Sustainable Development Goals, in which we commit that:

> "We will foster a dynamic and well-functioning business sector, while protecting labour rights and environmental and health standards in accordance with relevant international standards and agreements"[6].

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[4] Crown Estate (2017) Total Contribution report 2017
https://www.thecrownestate.co.uk/media/1023085/crown-estate-aw-1412-mb.pdf

[5] Kay, J July 2012 The Kay Review of UK Equity Markets and Long-Term Decision Making: Final Report
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/253454/bis-12-917-kay-review-of-equity-markets-final-report.pdf

[6] Resolution 70/1 adopted by the General Assembly on 25 September 2015. Transforming our world: the 2030 Agenda for Sustainable Development
http://www.un.org/ga/search/view_doc.asp?symbol=A/RES/70/1&Lang=E

Indeed the crucial role of business in securing environmental outcomes is highlighted in the Treasury's recently released 4th Natural Capital Committee report, which states that:

> "A programme of investment in natural capital by the private and public sectors is required to deliver the Government's 25 Year Environment Plan ambition. Resources and investment should be guided by valuations of the net benefits they generate. **The Government should actively promote corporate natural capital valuation, accounting and reporting**. Such action is important **because the private sector owns and controls much of England's natural capital**."[7]

2. Recent progress on reporting, but action required across a broader front

The Companies Act 2006 (Strategic Report and Directors' Reports) Regulations 2013 requires quoted companies to report on greenhouse gas (GHG) emissions and to report on environmental matters to the extent it is necessary for an understanding of the company's business within their Annual Report. This and Defra's 2013 guidance[8] are very welcomed.

However, other than greenhouse gases there remains a wide degree of flexibility in terms of which environmental parameters are monitored and reported and the methodology used. In addition none of this information is independently audited.

The Pensions Act 1995 requires a statement of investment principles (SIP) to be prepared and maintained and to include a statement of the trustees' policy on the extent (if at all) to which social, environmental or ethical considerations are taken into account in the selection, retention and realisation of investments. However, the environmental consequences of the policy are not required to be assessed or reported and there is no requirement to ascertain the environmental impacts of significant investment changes.

Companies other than quoted companies and pensions trusts are not required to report on any environmental attributes. Key regulations that could provide for environmental reporting, including the 'Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008', contain no reference to the environment or natural resources.

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[7] Natural Capital Committee 2017 Fourth state of natural capital report https://www.gov.uk/government/publications/natural-capital-committees-fourth-state-of-natural-capital-report

[8] Environmental Reporting Guidelines: Including mandatory greenhouse gas emissions reporting guidance Defra June 2013 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/206392/pb13944-env-reporting-guidance.pdf

In addition the Financial Reporting Council's UK Corporate Governance Code that "sets standards of good practice in relation to board leadership and effectiveness, remuneration, accountability and relations with shareholders." contains no mention of the environment[9].

The Office for National Statistics (ONS) has committed to developing a full set of national natural capital accounts by 2020. These accounts must key into the environmental accounting of companies as well as public bodies so that there is consistency in the gathering and analysis of data. Developing a shared language on environmental capital and impacts will be necessary if there is to be a fully joined up approach to ensuring a sustainable future. The sooner this process starts the better.

3. Corporate responsibility and duties

The Companies Act 2006 contains a duty on company directors in relation to the environment; clause 172 sets out that:

> "172. A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to—
>
> (a) the likely consequences of any decision in the long term,
> (b) the interests of the company's employees,
> (c) the need to foster the company's business relationships with suppliers, customers and others,
> (d) the impact of the company's operations on the community and the environment."

In should be noted that this is a weak duty as having looked at the company's environmental impact the director may legitimately conclude that he would be 'most likely to promote the success of the company' by not mentioning the impact to anyone.

While there are many environmental regulations to which companies must comply, there are very few duties that apply to businesses in relation to the environment.

The Principles for Business (Financial Conduct Authority 2017) (PRIN) sets out no specific expectations for the behaviour of businesses in relation to the environment[10]. There are principles that relate to protecting the assets of clients, paying due regard to the interests of its customers and treating them fairly, and fairly managing conflicts of interest between the

[9] Financial Reporting Council April 2016 The UK Corporate Governance Code https://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/UK-Corporate-Governance-Code-April-2016.pdf

[10] Financial Conduct Authority February 2017 Principles for Business https://www.handbook.fca.org.uk/handbook/PRIN.pdf

firm, its clients and its customers. But there is nothing that would indicate that outside these narrow parameters businesses are expected to be fair in how they manage, or impact on, natural resources and the environment.

Even inside the narrow parameters of PRIN companies are often unaware of the environmental interests of their clients and customers and therefore do not take basic actions. A survey by Aviva found that 81% of financial advisers believed that fewer than 10% of their clients had a genuine interest in ethical investments, while their customer survey found around 50% of consumers took ethical issues seriously[11]. Advisers also significantly underestimated the level of concern that customers had about climate change.

One duty that does apply to certain companies is the Natural Environment and Rural Communities Act 2006 Biodiversity Duty:

> 40 Duty to conserve biodiversity
> (A1) This section applies where—
> (a) Her Majesty's Revenue and Customs are exercising their functions;
> (b) any other public authority is exercising its functions in relation to England.
> (1) The public authority must, in exercising its functions, have regard, so far as is consistent with the proper exercise of those functions, to the purpose of conserving biodiversity.

In this case a number of companies must apply the duty as they are 'statutory undertakers' and hence fall under the 'public authority' definition. This creates an anomaly where a company that undertakes a statutory role in 2% of its business must apply the biodiversity duty across the whole of its business. Meanwhile comparable companies that are not statutory undertakers do not have to apply the biodiversity duty to any of their business. This creates an un-level playing field that is particularly apparent in the water industry.

There is no clear principle that explains why a civil servant or statutory undertaker should be subject to a duty to consider, protect or benefit the environment in undertaking their operations, while another body is allowed to avoid all such action.

If we compare this situation to a parallel sphere, the Health and Safety at Work Act 1974 establishes that "It shall be the duty of every employer to ensure, so far as is reasonably practicable, the health, safety and welfare at work of all his employees". This is a duty that has transformed health and safety standards and expectations for all employees over the last 45 years. If businesses were to have similar environmental duties towards their employees, stakeholders, clients, and even the public, this could result in a transformation in environmental standards and health.

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[11] Fernyhough J 6 February 2017 Ethical investment demand outstrips adviser interest FT Adviser https://www.ftadviser.com/investments/2017/02/06/ethical-investment-demand-outstrips-adviser-interest/

The Treasury's Natural Capital Committee has recommended that Government:

> "should reinforce existing environmental duties of public authorities, including those enshrined in Section 40 of the Natural Environment and Rural Communities (NERC) Act 2006, to conserve biodiversity, including restoring or enhancing species populations or habitats[12]

We believe that without increased responsibility being taken by non-government agents Government will over the next 25 years struggle to halt damage to the environment or to deliver on our international sustainability commitments. The best way to address this would be to ensure that current duties are enforced, and to further develop the framework of environmental responsibilities that apply to businesses, charities and government bodies.

Fostering environmental responsibility in the business community should ultimately lead to better environmental outcomes and reduced regulatory costs.

4. Board accountability

As the Lancaster University study quoted above illustrates Board level representation significantly adds to the level of attention paid to environmental issues and can thereby effectively improve the environmental and resource efficiency standing of a business, while managing and reducing environmental impacts.

As with other key Board functions useful focus can be brought to a business attribute by the presence of a non-executive director with the appropriate experience. Where appropriate this can be reinforced by the establishment of a specifically focussed board sub-committee.

There are no provisions in English company law or guidance for the establishment of Board members with environmental experience or for environment sub committees to the Board. Setting strict rules or parameters for the appointment of such directors or committees across a wide range of business types and sizes is unlikely to be an effective or welcome approach. However there is much scope for providing clearer recommendations that such appointments are strongly encouraged, and for regulating for their existence in large companies and certain relevant categories of businesses.

[12] Natural Capital Committee 2017 Fourth state of natural capital report

Q 14 Is the current corporate governance framework in the UK providing the right combination of high standards and low burdens? Apart from the issues addressed specifically in this Green Paper can you suggest any other improvements to the framework?

No, the UK corporate governance framework is inadequate in relation to the environment. The development of a consistent and integrated approach to environmental recording, reporting and accountability will be necessary if the UK is to achieve and maintain the 2030 Sustainable Development Goals. Consideration should also be given to creating level playing fields and aligning the purpose of business with society through the development of corporate duties and responsibilities as they relate to environmental resources and impacts and desired outcomes.

We consider that the following measures would improve the corporate governance framework:

1) The establishment of non-executive directors with environmental expertise in large companies and in medium companies in specified sectors, supported by an environment sub-committee where appropriate.
2) The inclusion of environmental considerations in the UK Corporate Governance Code and Principles for Business.
3) The introduction of more prescriptive guidance on environmental reporting that keys into the development of natural capital accounting metrics by the Office of National Statistics.
4) The introduction of auditing for the environmental content of annual reports.
5) A duty on pension schemes to consider long term issues, including the environment, and to report not only on the policies they apply but on the environmental effects of those policies.
6) The introduction of duties on company directors in relation to managing environmental resources and impacts.

"Many people wonder what good an extra percent or three of patrimony are worth if the society in which they are to enjoy retirement and in which their descendants will live deteriorates. Quality of life and quality of the environment are worth something, even if, or particularly because, they are not reducible to financial percentages."[13]

Wildlife and Countryside Link, February 2017.

[13] Freshfields Bruckhaus Deringer (October 2005) A legal framework for the integration of environmental, social and governance issues into institutional investment, UNEP. http://www.unepfi.org/fileadmin/documents/freshfields_legal_resp_20051123.pdf