



Traidcraft's response to Financial Services Authority's Discussion Paper 14: Review of the Listing Regime

Traidcraft

1. Traidcraft welcomes this Financial Services Authority's consultation on review of the Listing Regime. Traidcraft is a fair trade organisation encompassing a trading company (Traidcraft Plc) and a capacity building non-governmental organisation (Traidcraft Exchange), committed to using trade as a vehicle for poverty alleviation. Traidcraft Plc is the UK's largest fair trade company with an annual turnover of over £10 million per annum. Traidcraft is an active participant in the wider movement to promote fair trade.¹

2. Traidcraft works in developing countries with producers of agricultural, manufactured or handcrafted products whose circumstances effectively exclude or marginalise them from the mainstream trading system. Terms of trading are set in a way that ensures producers receive a price that covers a fair return on capital costs and labour, together with business training and support where needed. In particular Traidcraft works to establish trading relationships that are transparent, equitable and sustainable thereby ensuring that producers are able to overcome barriers to trade and establish sustainable livelihoods. Traidcraft views its work as actively contributing to the realisation of the Millennium Development Goals, which seek to reduce the number of people living in absolute poverty by half by 2015. Traidcraft works with producers from South and South East Asia, Central and South America, the Caribbean and East Africa.

Business can alleviate poverty in the right context

3. Traidcraft seeks to demonstrate the positive contribution that business can have on poverty alleviation in the developing world. However in order for this to take place it is vital for companies to be open, transparent and accountable, particularly with regard to their significant environmental, social, ethical and economic impacts. Increasing numbers of companies are realising the benefits of being transparent in their dealings, however the vast majority will not take action until legislation makes them.

Importance of maintaining stable environment for business to operate within

4. Businesses need the rule of law to operate effectively for them to undertake their activities in predictable manner. It is therefore important that business operations lead to or sustain stable societies, otherwise the rule of law is in jeopardy and businesses risk undermining their own operating environment. In this context the FSA needs to consider the long term operating environment of companies as part of its aims to maintain market confidence and protect investors.

Inclusion of non-financial considerations within corporate governance is supported by business and government

5. Traidcraft agrees with the need to review and reassess standards of corporate governance, particularly in light of the collapse of Enron, and are disappointed that the Annex A study has not provided more detail on this area. Traidcraft strongly believes that in the past there has been an over-dependence on financial goals and incentives. There is an increasing appreciation of the need to place social, ethical and environmental considerations alongside financials in companies' decision-making process to preserve the long term operating environment for businesses by both government² and business³.

¹ Other bodies that make up the Fair Trade Movement include the International Federation for Alternative Trade (IFAT) www.ifat.org; the Fairtrade Labelling Organisation (FLO) www.fairtrade.net and its UK representative, the Fairtrade Foundation (FTF) www.fairtrade.org.uk. Consumption of fair trade products in the UK grew by over 40 per cent in 2000/1.

² Department for the Environment and Rural Affairs' 'A Better Quality of Life, Strategy for Sustainable Development' (1999), and Department for International Development's 'Making Globalisation work for the Poor' (2000)

Provision of Information - Company Law and FSA listings regime

6. The current draft of the Companies Bill is weak if companies are to consider non-financial issues pertinent to business adequately. The Companies Bill needs to include measures to :

- increase directors' responsibilities in the consideration of non-financial issues
- require reporting that covers social, ethical and environmental risks.

This would start to meet stakeholder demands for transparency. There are areas within the listing rules which could go some way to redress these gaps in Company Law and introduce a more modern and transparent regime for listed companies. We believe that opposition to proposals which provide stakeholders with more information and make companies assess fully the impact of their actions stem either from a lack of understanding of the significant benefits to be gained by improved corporate governance (e.g. better knowledge of the business and increased confidence in the stock markets), or by a desire to conceal socially unacceptable policies and actions.

Overall response to Discussion Paper

7. Traidcraft is pleased to see that the FSA is consulting with interested parties and that it understands the value in doing so. However we feel that in order for these benefits to be real, the Consultative Committee must include representatives from a wider variety of organisations that are concerned about the long term impacts of business operations on society and environment.

8. Traidcraft is particularly concerned that deeming the Prospectus Directive a 'maximum harmonisation' directive, could weaken the UK's current corporate governance regime. Any moves to deem other EU legislation as 'maximum harmonisation' should be fiercely opposed. As this would:

- reduce any incentive for companies to behave in a responsible way
- reduce confidence in UK stock markets
- dilute UK standards (which are seen as the best in the world in relation to corporate governance)

9. Traidcraft has no objection to the Combined Code being reviewed by the proposed new Standards Board. However we do believe that it is critical that the Standards Board includes representatives from a wide range of organisations which are interested in the long-term, national and international impacts of business activities on society as a whole.

Specific responses to questions

Q1 Do you feel that the disclosure requirement imposed on issuers in the Listing Rules to state whether or not they have abided by the Combined Code is valuable?

Yes – but the combined code does not include sufficient guidance on non-financial issues.

1. A. A disclosure requirement does serve the purpose of focusing companies' attention. It gives them guidance on key corporate governance issues and to date as a voluntary disclose it has been a good first step enabling companies to concentrate on these issues. However the combined code content inadequately deals with the important matters it seeks to cover e.g. directors' skills, remuneration targets, the provision of information to the board and internal communication structures. These non-financial issues are fundamental to sustainable development and hence a company's social responsibility in that they govern the extent to which a company is directed to assess its impact on the wider community and has the incentive (at board level) to do anything about its impacts. These issues should not be simply side-lined with insufficient direction being given in the Combined Code on what is required.

1. B. The efficacy of the present system is linked to the content of the Combined Code, which needs updating. In particular the Combined Code must be amended in order to address changes to Company Law proposed in the draft Company Bill. Those companies producing Operating and Financial Review (OFR)

³ Association of British Insurers' Disclosure Guidelines on Social Responsibility (2001) and Turnbull Report on 'Internal Control: Guidance for Directors on the Combined Code' (1999)

under Company Law proposals must have additional obligations detailed in the Combined Code. The Combined Code must for example:

- ensure that company directors have sufficient qualifications or experience to enable the company to properly produce the OFR, or should ensure they gain such qualifications or experience prior to the Bill's implementation (amending Code Provision A.1.6)
- ensure that they provide adequate information on non-mandatory OFR matters to enable them to be able to decide whether particular matters should be included in the OFR (amending A.4.1)
- Code Provisions B.1 must be amended to reflect the fact that directors must take into account long-term factors and other non-financial matters such as the environment and their effect on supply chains and local communities (as explained in Paragraph 4 above).
- Code Provisions on Financial Accounting (D.1) will also need to be expanded to deal with non-financial issues e.g. companies must ensure that their auditors have sufficient qualifications and/or training to deal with the requirements of the OFR
- ensure that there is an adequate infrastructure in place to deal with the OFR (amending D.2)

Traidcraft assumes these amendments will be drafted by the Standards Board under the supervision of the FSA.

Recommendations on Q1 on Combined Disclosure requirement

- That all listed companies must comply with the Combined Code
- That the Combined Code should be up-dated urgently by the Standards Board with participation from non-corporate bodies to include not only disclosure of significant issues to companies but specifically how directors consider issues of significance to wider society. For example, company compliance with domestic legislation and internationally agreed standards/laws, such as UN Universal Declaration of Human Rights and International Labour Organisation's core conventions.
- That the FSA should monitor compliance with the Combined Code and be able to take action when a company fails to comply.

Q3 Have we identified the key issues that we should review in the area of corporate communication or are there other areas that you feel merit our attention? AND

Q4 Do the current corporate communication rules deliver all the necessary disclosures to maintain market confidence and protect investors?

No – Corporate Communications need to include disclosure by companies on how they identify, understand and manage their significant non-financial risks, which include social, environmental, ethical and economic impacts.

3/4. A. Traidcraft agrees that the provision of adequate and timely forward-looking information to market and investors is very important topic and that transparency is key to this. We welcome the Government's statement that "Information about future plans, opportunities, risks and strategies is just as important to users of financial reports as a historical review of performance"⁴ and the fact that it believes that "every director needs to consider [the environment] as first among equals"⁵. However Traidcraft strongly believes that the way to ensure that these laudable statements actually become a reality is by making companies assess, analyse and disclose more information on how they prioritise and manage social, ethical, economic and environmental issues. Companies need to explicitly commit to measuring and making year on year improvement on their significant social, economic, ethical and environmental issues.

3/4. B. Traidcraft plc has been producing social accounts since 1993, the latest report is available on Traidcraft's website www.traidcraft.co.uk. The social accounts report on Traidcraft's relationships with and impact on key stakeholder groups. Traidcraft has found that the social accounts have acted as a useful driver and source of information with which to better understand Traidcraft's effects on stakeholders (e.g. customers and suppliers), and monitor and improve the way the business is working. A case study of Traidcraft plc, which will include Traidcraft's experience of undertaking social accounts, is being written as part of a response to the Companies Bill consultation.

⁴ DTI White Paper 'Modernising Company Law' at 4.30

⁵ *ibid.* at 4.31

3/4. C. It is clear that most investors invest money in shares over the long-term. They are concerned with the long-term prospects of a company and need to know as much about its future risks as possible. When a company ignores or creates environmental risks, violates international and/or local laws, the result is not only to create conditions of social unrest but it can become the focus for flashpoints of unrest. This in turn leads to social instability where the rule of law cannot fully operate. Such a situation is not conducive for a company to continue to operate satisfactorily let alone grow and flourish. But currently companies do not need to look into their indirect and direct impact via supply chains or the environmental impact of selling a particular product and as a result the investor is left with insufficient information with which to gauge whether a company will be faced with a massive environmental damages claim or suffer reputational damage due to its ill-treatment or ignorance of the concerns of local communities.

3/4. D. Currently many companies do not undertake adequate risk assessment of these issues. Risk assessment of the direct and indirect operations of companies is needed to ensure a company prioritises action on the significant issues as they appear to them and as considered by wider society. Attention needs to be paid to indirect impacts, which may be more significant than direct impacts for some issues (e.g. labour standards within supply chains of agricultural processing companies and supermarkets), and in some sectors (e.g. financial services sector). These issues are of business concern and therefore need to be disclosed. For example the commodity crisis will jeopardise the smooth operations of large agricultural processing companies. In some commodity sectors where the farm gate price is below the cost of production all the younger members are leaving farms to look for better opportunities elsewhere. This will inevitably jeopardise the quality supply of that commodity in the future. In another commodity sector the social unrest between those in abject poverty and those with some employment on plantations is likely to boil over and impact on the operations and deliveries from those plantations.

3/4. E. A well known example from another sector is Shell in Nigeria. If Shell had had policies in place to deal with its impact on local communities in which it operates or if it had a system collecting appropriate information and sharing pertinent information between employees in Nigeria and head office, then one of the biggest reputational disasters of recent times may have been mitigated.

3/4. F. In order for a company to maximise positive opportunities, (let alone be sure that it is not violating human rights or on the brink of a PR disaster) it must be proactive in its approach to social, ethical, economic and environmental issues. Insufficient risk analysis of non-financial issues leave companies exposed. Where companies do take into consideration their impact on the environment, and the local communities in which they and their suppliers operate, then they have little to fear other than open debate. The present system merely benefits those who have something to hide at the expense of those who operate at the highest levels of corporate governance.

Recommendations on Q3 & Q4 on Corporate Communications

Traidcraft recommends that the FSA:

- Increase incentives for companies to disclose social, ethical, economic and environmental information, leading to mandatory reporting on these issues. In recognition of the importance to business operations of considering these relevant issues to their business, Traidcraft considers mandatory reporting of significant issues to be appropriate and that a timetable for mandatory reporting of these issues should be developed.
- Draft and implement rules or specific guidance, which requires companies to disclose specific social, ethical and environmental information in the prospectus and as part of its continuing obligations. As a minimum company disclosure should include their risk assessment process, including company compliance with domestic legislation and internationally agreed standards/laws, such as UN Universal Declaration of Human Rights and the International Labour Organisation's core conventions.
- Encourage companies to put in place integrated communication structures to ensure that information (other than financial results) are distributed within the corporate structure to enable company boards to make informed decisions. Companies should have adequate procedures in place report on their social and economic aspects, (e.g. within OFR) as per their production of financial reports.
- Does not move towards quarterly reporting as that would encourage companies to take an even more short termist approach. The current investment context of companies needs to be made conducive to long

term decision making, which also aligns with most investors timescales. Companies need to disclose more and higher quality information on how they consider in an integrated manner all significant issues to their business, including social ethical and environmental issues, not report more frequently.

Q5 What are your views on the contribution that the shareholder rights' provisions make to market confidence and investor protection?

5. A. The key reason for having and retaining the shareholder rights provisions is transparency. Given shareholders' role it is appropriate that they are kept informed at times when their rights could be diminished, and given the opportunity to approve or disapprove of particular transactions. The current system is more likely to create a strong body of active shareholders, by giving shareholders opportunities to act collectively and influence the company. Exercising of shareholder rights therefore should be promoted in a manner that encourages collaborative and more responsible shareholding. (This is a recommendation of Just Pensions' report 'Do UK Pension Funds Invest Responsibly?' (2002))

Q6 What role should the FSA as competent authority play in ensuring that financial information is of sufficiently high quality for investors?

6. A. The FSA, like other regulatory bodies must have regard for the long-term future of business operations. In this context it is important that the FSA ensure that the wider interests of society are considered and that the rule of law is not undermined. It is therefore important that a wide variety of stakeholders concerned with business impacts on society and the environment are involved in this consultation process over the FSA's role and the decisions over what constitutes sufficiently high quality disclosure. Non-corporate views need to be actively sought and considered.

6. B. There is a need to review the compliance enforcement mechanisms and monitoring of the FSA's listing regime to ensure that companies properly adhered to them.

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