

Inspired thinking



New report on the governance of occupational health and safety

Introduction

Insight is pleased to announce the publication of a new report entitled 'Defining Best Practice in Corporate Occupational Health and Safety Governance.'

The report seeks to define new standards of best practice in the governance of health and safety. It was commissioned by Insight in partnership with the UK Health and Safety Executive (HSE) and written by consulting company Acona. Insight's particular interest in the project was to establish an overall occupational health and safety (OHS) governance framework that investors could promote to the boards of companies in which we invest.

Background

The UK Health and Safety Commission (HSC) and the HSE are responsible for the regulation of almost all the risks to health and safety arising from work in Britain. In November 2004, the HSE set up its Business Involvement (BI) Programme, which is intended to promote the use of a range of non-regulatory measures and appropriate health and safety management techniques as an integral part of effective business management. Insight has been working with the BI Programme from the outset to try to ensure that it helps to improve understanding in the business and investment communities of the commercial benefits of good OHS. (For a review of this work see http://www.insightinvestment.com/Responsibility/Engagement/occupational_health_and_safety.asp).

Insight and HSE in partnership

In our discussions with the HSE, we noted an important omission in its policy framework, namely, that it does not offer a complete and up-to-date view on how boards should govern health and safety issues.

In general, the board agrees a company's overall policy and strategy. The board is also responsible for motivating and reviewing executive performance and for disclosing this performance to shareholders. All of these roles relate to OHS in some way. Examples of the questions that should be asked about OHS performance include:

- How should incentive structures of the executive directors, non-executive directors and the senior management be designed in order to motivate appropriate OHS performance?
- How should boards delegate responsibility for OHS, how should they monitor performance in this area and what is the specific function of non-executive directors in this regard?
- Do boards recognise the strategic relevance of good OHS management and what key performance indicators should they disclose to investors?

Given that the board of a company is its most important governing institution, we agreed to work with the HSE to develop guidance on the governance of OHS.

Key findings

The key finding of the report confirmed Insight's initial view that the existing HSE guidance is deficient. In particular, the report confirms that the existing HSC guidance on directors' responsibilities for OHS (INDG343) 'no longer reflects best practice governance in large UK companies, and is in need of updating'. The key problem identified was that the distinction between the role of executive managerial responsibilities and the governance role of the board of directors is not made clear. The report also claims that research has shown that 'there is evidence that in many sectors there is still a lack of engagement at the

highest levels in UK organisations,' and that 'directors are still unclear as to their role in OHS leadership and in ensuring that risks to OHS within their business are properly controlled.' More specifically, the report suggests that more detailed guidance is required in the following areas of OHS governance:

- How to incorporate OHS into existing governance structures (which for large companies involves the internal control procedures and the audit and remuneration committees).
- The role of non-executive directors vs. executive directors.
- How to effectively implement OHS management delegation.

- How to set objectives and monitor performance of the business and
- How to incentivise the executives to deliver good OHS performance.

Proposed best practice principles

In addition to the research into the existing guidance, Acona also held a series of stakeholder consultation interviews in order to propose an overall OHS governance framework that investors could promote to the boards of companies in which they invest. The report identifies seven key principles that should underpin OHS governance (see box below).

Best practice principles

1. Director competence

All directors should have a clear understanding of the key OHS issues for their business and be continually developing their skills and knowledge.

2. Director roles and responsibilities

All directors should understand their legal responsibilities and their role in governing OHS matters for their business. Their roles should be supported by formal individual terms of reference, covering as a minimum setting OHS policy and strategy development, setting standards, performance monitoring and internal control.

At least one nominated director (which could be the Chairman or preferably one of the independent non-executive directors, where they exist) should have the additional role of overseeing and challenging the OHS governance process.

3. Culture, standards & values

The Board of Directors should take ownership for key OHS issues and be ambassadors for good OHS performance within the business, upholding core values and standards. They should set the right tone at the top and establish an open culture across the organisation with a high level of communication both internally and externally on OHS issues.

4. Strategic implications

The board should be responsible for driving the OHS agenda; understanding the risks and opportunities associated with OHS matters and any market pressures that might compromise the values and

standards; and, ultimately, establishing a strategy to respond.

5. Performance management

The board should set out the key objectives and targets for OHS management and create an incentive structure for senior executives that drives good OHS performance, balancing both leading and lagging indicators and capturing both tangible and intangible factors. Non-executives (through the remuneration committee, where one exists) should be involved in establishing the appropriate incentive schemes.

6. Internal controls

The board should ensure that OHS risks are managed and controlled adequately and that a framework to ensure compliance with the core standards is established. It is important that the governance structures enable management systems, actions and levels of performance to be challenged. This process should utilise, where possible, existing internal control and audit structures and be reviewed by the audit committee.

7. Organisational structures

The board should integrate the OHS governance process into the main corporate governance structures within the business, including the activities of the main board and its sub-committees, including risk, remuneration and audit. In some cases, the creation of an additional board sub-committee to consider OHS (and/or risk/corporate responsibility) may be relevant.

Next steps

At a meeting of the Commissioners in May 2006, the HSC directed the HSE to improve the guidance that it issues to company directors on how they should govern OHS matters. This decision reflects the growing pressure being generated by the broader debate about corporate manslaughter. While better guidance for directors is seen by some as an interim measure towards tighter regulation, we believe that effective guidance supported by strong investor support could reduce the need for regulation.

Going forwards, the HSE has asked the Institute of Directors (IoD) to convene a group of stakeholders charged with developing a replacement set of guidance using the Acona report as a starting point. While this is an excellent outcome, there is of course no guarantee that the final HSE guidance will fulfil the requirements identified above. As a consequence, Insight will continue to seek to engage in this process. One practical measure that we will take is to distribute the report to the chairmen of FTSE100 companies, inviting them to engage with the IoD in the process of developing guidance.

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