

Board Leadership, Transparency and Governance consultation
Ofwat
21 Bloomsbury St
London
WC1B 3HF

21 August 2018

Dear Ofwat,

Proposed licence changes relating to Board Leadership, Transparency and Governance

This letter sets out our response to the consultation on potential licence changes related to Ofwat's review of Board Leadership, Transparency and Governance ('BLTG') principles. We would like to thank Ofwat for the consultation call on 9 August which helped clarify a few points within the consultation document.

We set out below our view against each of the consultation questions.

Q1: Do you agree with the objectives for the principles we have set out (in Table 1 of this chapter)?

We agree with the principles and objectives set out in Table 1.

Q2: Do you agree with the aim of setting principles that enable autonomy and flexibility for companies to deliver the highest standards of accountability and responsibility for their behaviour and outcomes, reflecting their own circumstances?

We agree that companies should be able to reflect their own circumstances whilst following the spirit of the principles that enable autonomy and flexibility for companies to deliver the highest standards of accountability and responsibility for their behaviour and outcomes.

Q3: Do you agree that if companies are unable (exceptionally) to comply with specific principles, they should explain very clearly how their approach meets the spirit of the principles?

We agree that companies should strive to comply with specific principles, however, recognising that in extremis, there will be occasions where compliance is not possible and in those cases (albeit rare) companies should be able to clearly explain how the approach they are taking is in line with the spirit of the revised principles, and/or the actions taken to recover from any temporary non-compliance. Where there is a particular event that results in companies not meeting a specific principle, they should seek to meet the spirit by balancing this across the principles as a whole, without this being considered a breach of a licence obligation.

Q4: Do you agree with our proposed principle for purpose, values and culture?

We support Ofwat in clarifying that in 2.1 iv, reference to the explanation of the board's activities and any actions taken is expected to be in the context of the board's requirement to align culture and behaviour with the company's purpose. We agree it is for companies to set its aspirations for those it serves in its annual reporting. It may be worth clarifying whether the annual statement is necessarily within an annual report itself. The original intention, which we support, is for this statement to be accessible. Therefore the form of it may not be solely in front of the financial statements, which was not specified as a requirement in the 2017 new requirement. Annual could be a minimum expectation, as it may be appropriate for this to alter in frequency or format to meet this principle.

We agree with the principle for purpose, strategy and values, and the specific reference to company and board culture. As we explain in Q5, the reference to reporting may be better in principle 2.2.

Q5: Do you agree with our proposed board leadership and transparency principle?

The principles largely reflect the requirements of FCA Disclosure and Transparency Rules and elements of the UK Corporate Governance Code, therefore, we are content with the proposed principle. The reference to purpose, culture and values in annual reporting in question 4 could be referenced in the principle in 2.2 and 2.1, given that this is a section on demonstrating the highest standards, which includes reporting on Board activities. We think the reference to the form and level of detail in 2.2, rather than necessarily specifying the location (as we suggest in Q4) would be supported by this distinction between establishing a purpose, strategy and values and the transparency on this being part of the highest standards of board leadership, transparency and governance.

Q6: Do you agree with our proposed principle for the stand-alone regulated company?

Ofwat may wish to consider amending 2.3 iii as the Board of many companies delegate certain decisions to their sub-committees. The current Board sub-committee regime works very well by allowing time outside normal Board meeting to deal with executive remuneration and other matters some of which are of a routine and administrative nature. Having all matters approved by the Board would in our view put increased pressure on the Board and may lead to a less time and focus on important strategic matters facing the business. There are also governance reasons why an audit committee, nomination or remuneration committee should make certain decisions which could be considered final, given that they have a defined role and corporate governance expectation that non-executive directors chair specified committees.

We broadly support the proposal but suggest that the Board does not make decisions on all matters and that delegation by the Board to sub-committees to make decisions is maintained. The principle that the Board retains responsibility for setting the delegation in its own corporate governance arrangements/rules of procedure could be how this is clarified. Principle 2.2v implies that this is intended, as does 2.4iii on the nomination committee.

Q7: Do you agree with our proposed board effectiveness principle?

We support and agree with the proposed board effectiveness principle. We think it will be useful for Ofwat to clarify that in 2.4 ii, the requirement to have an annual board evaluation does not necessarily need to be conducted by external assessors, or that an external assessment would need to be completed annually.

Q8: Do you think that the requirement for an independent chair should be a stand-alone licence obligation or should we allow some flexibility? If the latter, what mitigations would be appropriate where a company does not have an independent chair?

We do believe that the Chair should be independent and that the roles of Chair and the CEO should not be exercised by the same individual. There are already requirements in the UK Corporate Governance Code (A.2.1 and A.3.1.) to have separation of the roles of Chair and CEO and that the Chair should be independent. In addition, provision 21 of the proposed new Corporate Governance Code maintains this requirement.

We do not believe that there should be a licence condition relating to the Chair as this is covered by the UK Corporate Governance Code, and the general licence condition related to the BLTG principles.

Q9: Overall, how well do the proposed principles meet the aim of enabling autonomy and flexibility for companies to deliver the highest standards of accountability and responsibility for their behaviour and outcomes, reflecting their own circumstances (rather than setting overly prescriptive rules)?

We think the proposed principles will allow autonomy and flexibility and allow companies to reflect their own circumstances. Ultimately, we support Ofwat's view that it should not be setting overly prescriptive rules. However, we recognise that companies need to support Ofwat's approach through how they operate in practice, and the transparency and leadership they show in maintaining legitimacy for the customers they serve. Over the recent months Ofwat and the Secretary of State Michael Gove have made it very clear that companies are expected to deliver the highest standards of corporate accountability and responsibility for their behaviour and outcomes, and prescriptive rules could ultimately be required if this is not achieved

Q10: Do you agree with our proposal to insert a requirement in companies' licences that they must meet the principles?

Subject to our comments made in relation to the questions 1 to 9 above, we are content that the proposal to insert a requirement in their licence that companies must meet these principles.

Q11: Do you agree with our proposal for an appeal mechanism and a change process in the proposed licence condition to meet the principles?

We support the appeal mechanism. In practice it should not be required for as long as a principles-based approach is reflected in the BLTG guidance.

Q12: Are there specific instances where individual companies' licence conditions might conflict or overlap with the revised principles?

Other than comments made in relation to the questions 1 to 9 above, we do not believe that for Bristol Water there are instances of conflict or overlap with the revised principles.

Q13: Do you agree that we should insert a requirement in companies' licences that independent non-executive directors should be the single largest group?

We are content that there is a licence requirement for independent non-executive directors to be the single largest group on the Board. However, there may be occasions where for a short period of time this may not be possible (i.e. immediate resignation or death) in which case we would expect Ofwat to accept this was not a breach of the principles, provided that the company is making prompt efforts to resolve the situation. This should be reflected in the licence condition.

Q14: Do you agree with our proposal to use the criteria for independence as set out in the UK Corporate Governance Code? Do you think that there are any merits in instead setting out an alternative approach whereby we would insert criteria for independence in the licence?

We support the proposal to use the criteria for independence as set out in the UK Corporate Governance Code. We do not see a need to create a new set of criteria.

Q15: What are your views on the merits of going further than our proposal and instead requiring that independent non-executive directors to be the majority on the board? If we take this approach, should this be a sub-principle or licence requirement?

We do not support any proposal requiring independent non-executive directors to be the majority on the Board. This may not on its own result in improved board governance, recognising the additional cost that would be incurred, and also the challenge finding suitably experienced candidates given the engagement and assurance requirements the Board of a regulated company has to apply, including enhanced standards of leadership, transparency and governance that rightly applies to providers of essential public health services to consumers. Board effectiveness may be constrained by such prescription. We do not think the distinction between a sub-principle or licence requirement is particularly important, as although a sub-principle this would allow flexibility to explain why independent non-executives were not in the majority, it would add little in practice given the principle that links Board effectiveness reviews to Board composition in 2.4ii There is increased focus on Board leadership, transparency and governance with this consultation and the consultation on proposals for a new UK Corporate Governance Code. As a final point, companies may need a period of time to transition to the new principles. Therefore the suggestions we made in the June 2018 “change of control” consultation response on the BLTG licence change proposal, including allowance for exceptional circumstances and the need for a period of transition, are also relevant to this consultation. We support the approach Ofwat are taking and hope that our points are helpful in finalising the principles and licence changes.

Yours sincerely,

A large black rectangular redaction box covering the signature of the sender.

Chief Executive

Sent via email to: FinanceAndGovernance@ofwat.gsi.gov.uk