February 28, 2018

Catherine Horton  
Financial Reporting Council  
8th Floor  
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London  
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Dear Catherine,

Re: Proposed Revisions to the UK Corporate Governance Code (Code)

Royal Dutch Shell plc welcomes the opportunity to respond to the Financial Reporting Council’s (FRC) consultation on changes to the Code. We understand there is political will for reform and a need to increase public trust in UK companies. We continue to support the underlying objectives of the Code, which are to promote good corporate governance that incentivises businesses to take the right long-term decisions. In our view, it is important that the reforms meet the Government’s objectives in a manner that maintains the UK’s competitiveness as a place in which to locate and to do business. In doing so, the UK can continue to remain competitive and attractive to both UK and international issuers. At the outset, we would like to state that we broadly support the GC100 and CBI responses to the UK Government’s Green Paper consultation on corporate governance reform. We also support the GC100’s response to this FRC Code consultation as well as the CBI’s response on the proposals in relation to board independence and workforce engagement.

We set out in this response some concerns we have about the detail of proposed revisions to the new Code. In particular, the proposed changes to directors’ independence, the on-going requirement for the chair to be independent and the remit of the remuneration committee will, in our view, reduce the flexibility available to multinational companies and are against the best interests of the members as a whole. We would favour instead maintaining the board discretion to determine whether the test for independence is met, retaining the provision requiring the chair to be independent at appointment (but not thereafter) and maintaining the current remit of the remuneration committee. We are also concerned that the proposals in relation to Section 172 of the Companies Act are overly prescriptive and potentially expand the interpretation of the existing law. In our view, it would be better if the new Code simply cross-refers to the proposed forthcoming legislation on Section 172.
Q1. Do you have any concerns in relation to the proposed Code application date?

Yes, please see our response to Q7 below. We believe that if the new Code retains the proposed changes on independence in Provision 15, it should provide for a transitional period to provide sufficient time to allow companies to comply with those changes.

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

The aspiration for strong relationships with employees and stakeholders is supported by Royal Dutch Shell plc and its subsidiaries (Shell) and indeed Shell already engages extensively with employees through a range of formal and informal channels including town halls, webcasts, breakfast briefings, employee forums, interviews, helplines, annual employee surveys, and Shell Online. The board also engages directly with staff, for example during site visits and participation in town halls or other events, and also receives annual reports from the employee survey. These engagement channels help senior management and the board understand the views of the workforce and vice-versa. Therefore, in view of the flexibility on workforce engagement mechanisms noted in the Guidance on Board Effectiveness (Guidance), we presently consider this to be an area where our current approach is effective. However, given the global nature of our business, we believe the new Code should avoid a ‘one-size-fits-all’ prescriptive approach and be clear on the flexibility afforded to companies. In particular, Provision 3 should explicitly state that companies are permitted to either (i) engage the workforce through one or a combination of methods such as those provided in Paragraph 35 of the Guidance or (ii) adopt another appropriate mechanism designated by the board. We also believe it would be helpful if the FRC in Provision 3 substituted the word “normally” with the words “for example” to make it abundantly clear that companies have the flexibility to adopt a number of methods. Additionally, we believe the potential of any form of global employee representative at the board level (though not currently required) is not warranted in view of our current engagement processes, which support the importance of maintaining engagement ideally at the site or country level first. Additionally, we request that the FRC provide greater clarity on the scope of the term “workforce” in Provision 3. In our view, the scope should be restricted to employees or companies should have the discretion to determine the appropriate scope of the term. Alternatively, the new Code should explicitly list the categories of workforce that are excluded, for example, employees of an outsourced service provider that provides services to a listed company.

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?

Shell has engaged with key stakeholders (including shareholders, its workforce, suppliers, customers, government, local communities, NGOs, etc.) for many years through transparent communication and by forming strong long-term stakeholder relations. We use a variety of channels with the aim of promoting greater mutual understanding of perspectives and to help the business make better-informed decisions. Shell’s engagement strategy has been a sustained process, which is frequently strengthened where feasible. While we are supportive of the UN SDGs (and report on such in our Sustainability Report) and certain other NGO principles, we do not support the new Code or the Guidance adopting such specific references. Doing so would create an unprecedented link to specific external principles (which could change) and does not necessarily
enhance corporate governance. Further in our view, the FRC should promote consistency in the application of principles and by identifying and including specific goals from a defined group of NGOs, the new Code unnecessarily limits the flexibility of companies approaching the area of sustainable development in a way that makes sense for their company, industry and stakeholders.

Q5. Do you agree that 20 per cent is ‘significant’ and that an update should be published no later than six months after the vote?

In our view, the prescriptive requirements outlined in the consultation imply that companies must take action and engage following the vote. However, the requirements do not recognise that many companies engage during the planning and drafting stages of preparing a resolution being proposed to shareholders. In this situation, the directors are very clear on investor opinion, and they draft a proposal that they believe would be most likely to promote the success of the company for the benefit of its members as a whole.

In a remuneration context, companies should be able to have incentive structures that are specific to their business context. The challenge for companies is to align their incentive structure to the company’s purpose, strategy and values within a framework with metrics that a majority of investors can support, even though their preferences will differ. A requirement that, in the event of a 20% vote against a resolution, a company will be listed on a public register and be required to take certain action and engage following the vote, could restrict variation in remuneration policy design that is needed to support different business models and strategies or which drive long-term sustainable performance. In our view, Provision E.2.2. in the current Code, that provides boards with the flexibility to determine the definition of “significant” remains appropriate.

Additionally, Shell requests clarity from the FRC on whether the proposed amendment to the Code (i.e. 20% against threshold) is limited to resolutions proposed by the board or whether it also includes shareholder proposed resolutions. For example, if a company consults extensively with shareholders on a shareholder proposed resolution, and subsequently recommends shareholders vote against that resolution, it would be a somewhat anomalous outcome, to expect the company to engage further on a proposal that neither the majority of shareholders nor the company supports.

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

In our view, the ongoing independence requirement for the chair coupled with the mechanistic application of the independence criteria is too rigid. The drafting of this proposal is too restrictive and harms shareholder interests and good governance. Ensuring that chairs have sufficient experience as a non-executive director with a company prior to taking on the role of chair, has long been encouraged. The Higgs Review (January 2003) recommended that in view of the chair’s hybrid role (the hybrid nature of the role is also recognised in Paragraphs 50 and 60 of the Guidance) it would be unnecessary and inappropriate for a chair to continue to be independent post appointment in order to successfully fulfill his/her role. If the FRC intends to move forward with the proposal as drafted, it would be helpful if it could explain what has changed such that this requirement needs to be introduced.

Shell believes that the new proposal has the potential to penalise boards with strong chairs by inhibiting their ability to analyse ongoing effectiveness. It also frustrates continuity of stewardship. Particularly for large multinationals in complex industries, having a chair with sufficient experience...
as a non-executive director to better understand the company and its industry is in its members’ best interests. This rule poses an obstacle to that objective and effectively reduces the pool of strong experienced candidates sufficiently qualified for the chair role.

In our view, the fact that chairs who engage extensively with shareholders, are subject to annual re-election sufficiently incentivises companies to ensure their chairs are performing effectively with appropriate independent judgment. However, if following consultation, the FRC believes that change is needed in this area, we believe the “clock” should begin upon the chair’s first election as chair or that the new Code should allow either for a grandfathering of existing chairs or a transition period for compliance under the new Code.

Additionally, the FRC’s statement in the Consultation Paper acknowledging that strong chairs could continue beyond nine years with a sufficient explanation discounts the potential that some investors, despite the “comply or explain” basis of the Code, could automatically vote against that chair’s re-election due to technical non-compliance with the Code without sufficiently evaluating the Company’s justifying explanation. Thus, if the FRC proceeds to adopt its proposal, we believe the enforcement of the UK Stewardship Code should be strengthened in parallel with amendments to the Code and institutional investors and/or proxy advisors should be discouraged from any mechanical adoption of a tickbox approach that results in an automatic vote against non-compliance without sufficient evaluation of the explanation for non-compliance.

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

Yes, please see our response to Q7. Moreover, in our view, the practical effect of prescribing a maximum period of independence is to impose a maximum period of tenure of 9 years, which is not likely to promote the success of the company for the benefit of its members as a whole.

Q9. Do you agree that the overall changes proposed in Section 3 of revised Code will lead to more action to build diversity in the boardroom, in the executive pipeline and in the company as a whole?

Diversity has long been the focus of global and local initiatives across Shell and is already a strong focus of the board’s nomination committee in succession planning for both the board and executive committee. Shell welcomes the Government’s motivations but would appreciate more clarity on the practical implications of the new Code’s requirement for the nomination committee to ‘oversee the development of a diverse pipeline for succession.’ If one such implication is for the nomination committee’s formal remit to expand to reviewing appointments beyond the executive committee (e.g., the Guidance notes ‘the nominations committee should take an active role in setting and meeting diversity objectives and strategies for the workforce “as a whole” and to monitor the impact of diversity initiatives’), we believe that would not only blur the distinction between executive and non-executive responsibilities, but would also have implications on the time and focus the nomination committee applies to effectively (with rigour) meet its other responsibilities (including non-executive director appointments and corporate governance). In addition, we believe the new Code proposals removing the board’s discretion to determine the independence of non-executive directors who, for example, hold cross-directorships could inadvertently reduce diversity in the short to medium term in some companies.
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.

Shell has had a well-established process in place for many years to progress diversity. Since 2004 we have consistently disclosed progress on gender diversity, nationality diversity and inclusion through our annual report and have set internal diversity targets for the leadership and talent pipelines over that period. Additionally, Shell is pleased that it currently ranks well vis-à-vis the Hampton-Alexander targets. Shell has made a timely submission to the Government Equalities Office gender pay gap review and has provided additional public reporting to aid greater transparency. We also expect to take part in the Parker Review ranking in due course. We would make the point, however, that reporting levels of ethnicity in executive pipelines may be an unreliable metric given that in some jurisdictions the gathering of data regarding ethnicity is not permitted, whilst in other jurisdictions, where disclosure of ethnicity is voluntary, an incomplete dataset may well be inevitable. Shell (and companies in general) will also need to be mindful of their obligations under the relevant data protection legislation.

Given that Shell is a multinational group of companies facing these inevitable challenges, further clarity will be needed on whether the proposal is specific to ethnic groups within the UK or whether it is intended to have global applicability which would both complicate implementation given the differences in legislation discussed above and also cause potential difficulties for the regulator in making comparisons. Shell also requests greater clarity from the FRC on the details of the new proposed reporting requirement. Overall, Shell would prefer to maintain the voluntary disclosure processes in place since 2004.

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?

In our view, a key remuneration principle is remuneration consistency across Shell, as consistency builds a culture of alignment with Shell’s purpose, strategy and values and a common approach to sharing in Shell’s success. We therefore agree with the intention that the board’s remuneration committee should be able to satisfy itself that remuneration policies and practices across the company promote long-term success and are aligned with its strategy and values. However, the practical implication should not be that the remuneration committee remit expands to either ‘set’ the remuneration for senior management/company secretary nor to ‘oversee’ remuneration and workforce policies and practices for all staff. We are concerned that such changes inadvertently blur the line between the board’s remit and management accountability. In our view, the distinction between, and separation of, oversight versus management responsibilities, remains foundational to good governance. We note that the FRC has indicated that it does not intend to stretch non-executive directors into an operational management role and we welcome and support this position entirely.

In our view, the new Code should retain the first sentence in Provision 33 of the current Code. Shell believes, that the existing governance structures and processes in place are appropriate and that the remuneration committee should set the tone and remuneration levels and structures at the executive director level while, enabling the CEO and management to determine the pay below the board, where they benefit from a closer line of sight to specific country and line of business context. Strong principles-based board oversight of directors’ remuneration allows management to be held properly to account when considering remuneration structures and policies below the
board. For example, management must be able to take into consideration factors such as the need to manage cost of employment commitments, review market practice and competitiveness, and comply with local legislation; and be accountable to the board, and able to justify to staff, such decisions.

The definition of “oversight” is unclear and the proposed expansions to remit inevitably have implications for the time the remuneration committee will need to devote to its role. This is particularly concerning given that the time presently required, for our remuneration committee chair in particular, has already increased in recent years due to increasing governance, shareholder and public attention. Any additional pressures on the remuneration committee’s time has to be in the interests of, and clearly aligned to, good governance. Notwithstanding the overlap with management responsibilities, the complexities of pay structures and legislation across different businesses and countries in which Shell operates, would lead one to question whether this is an appropriate use of the committee’s time, and whether management are better placed to deal with such topics.

For the avoidance of doubt, it is worth noting that Shell’s remuneration structures for executive directors and senior management are consistent with those of the wider workforce in key areas, which already ensure reasonable alignment with the intent behind the proposed revisions, such that pay levels and benefit arrangements are proportionate and aligned. This is evidence that prescribing remuneration committee oversight is not a pre-requisite for companies to take appropriate management decisions.

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

Please see our response to Q5 above. In our view, a fundamental principle in enabling remuneration committees to drive long-term sustainable performance is that the new Code does not adopt a ‘one-size-fits-all’ approach. Companies should be allowed to design their incentive structures in a manner that promotes long-term sustainable performance.

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

Shell welcomes Provision 37 on the use of discretion to adjust formulaic outcomes. As noted in our Annual Report and Form 20-F for the year ended December 31, 2016, Shell’s remuneration committee has a history of applying discretion to adjust the mathematical outcomes where the measurement of performance condition(s) has not reflected the actual performance of Shell or an individual.

Your sincerely,

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Company Secretary