BHP SUBMISSION TO FINANCIAL REPORTING COUNCIL (FRC) CONSULTATION ON PROPOSED REVISIONS TO THE UK CORPORATE GOVERNANCE CODE

28 February 2018
BHP Submission

Background on BHP

BHP welcomes the opportunity to participate in this FRC consultation on proposed changes to the UK Corporate Governance Code (Code). We operate under a Dual Listed Company (DLC) structure with two parent companies, an Australian company (BHP Billiton Limited) and a UK company (BHP Billiton Plc), operated as if we were a single economic entity, which we refer to as BHP. We have listings on the Australian, London, Johannesburg and New York stock exchanges and therefore we are subject to a number of regulatory regimes including that of Australia, the United States and the United Kingdom. We therefore have practical experience of how the UK’s corporate governance regime compares internationally, and are able to comment on the consultation paper from this perspective. We do not wish to respond on each point, but have made responses to some of the questions set out in the paper.

Our response is organised in three sections. The first covers the most significant points we wish to convey. The second makes comment on points of detail in either the Principles or the Provisions that are not covered by the specific questions of the consultation. Mostly these are areas where we believe the new drafting is unclear as currently presented, or where additional clarity may avoid future uncertainty. The third section responds to some of the consultation questions.

Key points

The UK is a global leader in corporate governance developments. UK listed companies have generally maintained high standards of corporate governance in recent decades. In any regulatory or compliance regime there are always likely to be outliers that receive interest and attention for their relatively poorer performance or conduct.

We believe it is important that the Government and the FRC ensure that the regulatory framework continues to reflect the conduct of the majority, that maintains high standards, and changes target the minority outliers and further lift their performance.

In particular, we welcome the increased focus on diversity in all its forms, at board level, in senior management and throughout the executive pipeline; and the inclusion of ‘discretion to override formulaic outcomes’ into the Code to ensure boards consider whether a remuneration outcome is appropriate given the circumstances of the company.

We have significant concern with a small number of proposed changes, as follows.

1) Alignment with section 172

We agree wholeheartedly with the statement in the draft Code’s introduction:

“Companies do not exist in isolation. Successful and sustainable businesses underpin our economy and society by providing employment and creating prosperity. To succeed in the long-term, directors and the companies they lead need to build and maintain successful relationships with a wide range of stakeholders. These relationships will be successful and enduring if they are based on respect, trust and mutual benefit. Accordingly, a company’s culture should promote integrity and openness, value diversity and be responsive to the views of shareholders and wider stakeholders.”

However, we believe the wording in Principle A should be revised to ensure it is consistent with section 172 of the Companies Act. The draft wording reads “A successful company is led by an effective and entrepreneurial board,
whose function is to promote the long-term sustainable success of the company, generate value for shareholders and contribute to wider society.” The highlighted words do not reflect the statutory duty. The duty is to act in the way the director 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 to a number of matters. The likely consequences of any decision in the long term is one of the matters to which regard must be had, as are the interests of employees; the need to foster business relationships with suppliers, customers and others; and the impact of the company’s operations on the community and the environment.

We agree with the FRC that companies will be successful for their shareholders only if they have strong regard for the stakeholder groups mentioned in section 172. However, in the interests of avoiding confusion, we suggest that the language in Principle A be revised so as to be consistent with section 172.

2) Change in approach to independence

We do not support the proposed ‘hard-wiring’ of the definition of independence in Provision 15 (i.e. the change from a list of criteria that boards should take into account in their assessment of independence, to a position where a director “should not be considered independent” if any of those criteria apply).

A particular concern is how this revised approach would operate in practice, in relation to the nine-year tenure criterion. We believe the current approach works well: it ensures that boards apply a particularly critical analysis to independence if a director has been on the board for at least nine years, but leaves open the possibility that the board may nonetheless make a determination, after considering all relevant factors, that the director remains independent.

The consultation document (paragraph 53) intimates that the less-flexible approach would be supportive of board refreshment. The evidence, however, shows the average tenure among Top 150 FTSE non-executive directors is four years. The data does not, therefore, indicate a need to have a less-flexible approach to independence classification as it relates to tenure.

3) Applying the independence test to the chairman

Provision 15 of the proposed new Code applies the same independence criteria to the chairman as to the other non-executive directors. That marks a change from the Code’s approach over the past 15 years.

Fifteen years ago, the report of the Higgs Review concluded:

“at the time of appointment the chairman should meet the test of independence. … Once appointed, the chairman will have a much greater degree of involvement with the executive team than the non-executive directors. Applying a test of independence at this stage is neither appropriate nor necessary.”

We believe that the Higgs approach has worked well, and consider that the proposed Principle E achieves the policy objective: “The chair should demonstrate independent and objective judgement.”

Applying the nine-year tenure criterion to the chairman is of particular concern. Acknowledging that the point is covered by the ‘comply or explain’ principle, the explanatory material in paragraph 54 of the consultation document suggests an expectation of a hard-stop at nine years. The danger is that some in the market would treat nine years as a rule rather than a matter of comply or explain. This would mean that a director with more than five years’ service on the board, who is appointed as chairman, would be expected to serve in that role for only four years. This may serve to limit options when considering the best person for the role. Not only does this raise issues for internal board succession planning, but, given that a robust succession process would see a staggered process for the chairman and CEO, it could also affect CEO succession. We believe that the interpretation of this provision by investors, advisers and corporates will lead to an increase in chairman succession processes and a shorter average chairman tenure.

4) Methods for gathering workforce views

We agree with the opening sentence in Provision 3: that the board should establish a method for gathering the views of the workforce. However, while the drafting of Provision 3 leaves open the possibility of an alternative method, the statement that the method would “normally” be one of the three listed could, over time, be treated by some market participants as the three acceptable methods.

Given the diversity of sectors, size, geographical operations, etc, of listed UK companies, it is entirely possible that some companies will currently have a superior method for gathering workforce views, and that other strong
methods will emerge over time. Perversely, there is a danger that highlighting three methods in the code could prevent the development of innovative new methods as envisaged by the guidance.

Regarding the three methods listed in Provision 3, as we said in our response to the Government’s corporate governance green paper, we do not agree that an individual director should be responsible for a particular stakeholder group. Having a number of non-executive directors each of whom is required to consider a single interest group (such as employees, shareholders, customers or suppliers) may serve to weaken the unitary structure of the board by effectively asking those non-executive directors to consider each board proposal always through a particular lens.

5) Remuneration committee remit

We have two concerns with Provision 33.

First, the wider remit for the remuneration committee includes ‘oversee[ing] … workforce policies and practices’. There is no limitation of these policies and practices to matters relating to remuneration. Paragraph 85 of the consultation document acknowledges that “Some companies may feel that it would be more appropriate to delegate some of the oversight for workforce policies to other committees where these exist as they might be better placed to deal with such matters. Examples include sustainability committees, corporate responsibility committees or people committees” (and this is reflected in paragraphs 104 and 105 of the revised Guidance). However, Provision 33 is a comply or explain provision, and therefore any allocation of responsibility for monitoring workforce policy and procedures to another committee(s) would require a formal explanation for departing from the benchmark standard. This is worthy of reconsideration by the FRC.

We believe the intent of the new remit is probably to ensure that the remuneration committee has an awareness of relevant wider workforce practices and takes them into account when considering executive pay. However, the Code drafting does not achieve this. We consider that it would be better for the board to be held accountable for the wider remit, to be delegated as it so chooses, with the remuneration committee responsible for cross referring to the relevant board or committee discussions on the appropriate topics.

Second, we do not support the proposal that the remuneration committee (or the board, if our suggestion above is accepted) has responsibility to “oversee” workforce policies and practices as this word could imply a blurring of responsibilities between board and management. Having an awareness of, and “monitoring”, key workforce policies and practices, would be a preferable formulation.

Items of note that are not covered by specific questions

Introduction – Reporting on the Code

We note the emphasis given to reporting on how the Principles have been applied. This may well serve to add length to corporate disclosure which would be against the direction of travel for reporting generally, particularly in an international context.

Provision 7 – Management of conflicts of interest

The management of conflicts of interest is an important responsibility of the board. However, we consider that duplication between legal requirements (which are therefore not ‘comply or explain’) and the Code should be avoided (except where there is a practical advantage such as that outlined in paragraph 73 of the consultation document). On the basis that the Code does not currently include a provision related to conflicts, and conflicts are well covered by the Companies Act (section 175) and the Listing Rules, our view is that Provision 7 is superfluous in the amended Code.

Principle Q / Provision 33 – No Director should be involved in deciding his or her own remuneration outcome

Principle Q reflects current Principle D.2, with the word “outcome” added. This is a logical amendment. However, proposed Provision 33 departs from current Provision D.2.3 without a supporting rationale in the consultation document; and departs in a manner that could be interpreted as inconsistent with Principle Q. Currently, Provision D.2.3 says ‘The board itself or, where required by the Articles of Association, the shareholders should determine the remuneration of the non-executive directors within the limits set in the Articles of Association. Where permitted by the Articles, the board may however delegate this responsibility to a committee, which might include the chief executive.’ Principle Q says ‘No director should be involved in deciding his or her own remuneration outcome’ but then Provision 33 says ‘The remuneration committee should have delegated responsibility for … setting
remuneration for the board'; this could be interpreted as inconsistent with Principle Q. Further clarity, as potentially indicated in paragraph 107 of the guidance, would be helpful to remove any ambiguity and would help to explain the supporting rationale for this change.

**Provision 33 – Determining the policy for director remuneration and setting remuneration of the board and senior management**

The drafting of this provision makes it appear that the remuneration committee does not have accountability for determining the policy for senior management remuneration. In relation to directors/the board, Provision 33 refers to (i) determining the policy, and (ii) setting remuneration. However, in relation to senior management, it refers only to setting remuneration. It is recommended therefore that the drafting be tightened to make it clear that the remuneration committee’s role, as regards senior management, includes the determination of remuneration policy.

Senior management is defined in footnote 3 of the draft Code as including the company secretary. This is a change from Provision D.2.2 of the current Code. Where the company secretary is not a member of the executive committee or the first layer of management below board level, it is not clear why their pay should be a matter for the remuneration committee. The consultation document does not provide a rationale for this proposed extension of the remuneration committee’s remit.

In addition, we note that footnote three defines ‘senior management’ in a way that is more prescriptive than the phrasing used in the existing code which refers to ‘determined by the board but should normally’ include the first layer of management below board level. The re-insertion of ‘determined by the board but should normally’ in the footnote three definition would be helpful to avoid unintentionally constraining the definition too rigidly.

**Provision 36 – shares granted or other forms of long-term incentives should be subject to a vesting and holding period of at least five years.**

We agree that, in normal circumstances, shares granted or other long-term incentives should be subject to a vesting and holding period of at least five years. BHP adopted a five year performance (and vesting) period for its long term incentive plan in 2004. However, the intention of this principle is unclear. We assume that “shares granted” relates only to long term incentive plans or restricted stock, and that deferred equity granted as part of an annual bonus plan (which often has deferral periods of less than five years) is not in scope. If not, an unintended consequence of requiring deferral for five years from an annual bonus could be that cash-only bonus payments are used as an alternative.

**Provision 41 – reasons why the remuneration is appropriate using internal and external measures**

In relation to the second dot point, it should be made more clear that “measures” relate to items like those set out in paragraph 113 of the revised Guidance on Board Effectiveness. It is unclear in the draft Code what ‘measures’ means in this context and whether the FRC is explicitly seeking a quantitative or qualitative rationale.

**Consultation questions**

*If you wish to make general comments not relating to the following questions, please state clearly the Principle or Provision the comment relates to, so that these can be more effectively captured as part of the post-consultation review.*

**UK Corporate Governance Code and Guidance on Board Effectiveness Questions**

**Q1. Do you have any concerns in relation to the proposed Code application date?**

No.

**Q2. Do you have any comments on the revised Guidance?**

In our comments in this submission, we have identified certain areas where the Guidance offers more clarity than some of the text in the Code itself. Our proposal would be to use some of the Guidance language in the Code to avoid misinterpretation in these areas.

In addition, it is disappointing that the Guidance has been framed as a completely separate document to the Code without cross referencing between the Principles and the Provisions and the Guidance. This may add complexity as companies search for ways to adhere to best practice.
Q5. Do you agree that 20% is ‘significant’ and that an update should be published no later than six months after the vote?

We agree that 20% is significant, but consider that six months will not always provide sufficient time to publish an update. It can be difficult to understand exactly which funds have not supported an item, and where an institutional holding is below certain thresholds it can be difficult to understand the rationale. There is an opportunity here through the Stewardship Code to recommend, on a comply or explain basis, that investors should send a rationale to companies in the event that they decide not to support the recommendation of the board. This would be beneficial, if material, in advance of the meeting, or, if not material, as soon after the meeting as possible to aid board analysis.

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

We understand that nine years has been referred to in the UK Corporate Governance Code for many years. As a result it has been adopted by many investors as a guidance for their voting. We do not, however, consider it to be appropriate for the chairman for the reasons set out in our Key Point 3), above.

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

Yes, for the reasons set out in our Key Points 2) and 3), above, we agree.

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

We believe that increased diversity has a positive impact on board and broader corporate performance. BHP’s experience shows that improved diversity in our workforce is associated with improved safety and productivity performance. That is why BHP has set an aspirational goal to achieve gender balance across the company by 2025. The revised Code provides more focus on specific elements of improving diversity such as acknowledging the importance of the executive pipeline and succession planning. Companies are provided with ways to improve diversity which could lead to more action. As an addition, it may be worth referring to the Voluntary Code for executive search firms and reaffirming the importance role many different organisations have to play in bringing gender equality to British boardrooms. Search firms and other organisations are a vital part of the process and can help shape outcomes.

Q10. Do you agree with extending the Hampton-Alexander recommendation beyond the FTSE 350? If not, please provide information relating to the potential costs and other burdens involved.

As a FTSE 100 company we do not have a view. However, broader application of the recommendation could aid the strength of the overall talent pipeline, and help with our own hiring, if all listed companies were expected to follow the recommendations.

Q13. Do you support the removal to the Guidance of the requirement currently retained in C.3.3 of the current Code? If not, please give reasons.

Yes. It is appropriate to treat the audit committee like the other committees in this respect.

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?

No. Please refer to the reasons outlined in our Key Point 5), above.

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

As we noted in our response to the Government’s corporate governance green paper, we welcome the inclusion of the phrase ‘discretion to override formulaic outcomes’ into the text of the updated code.