New Energy and Water Public Interest Network
New-Pin

Energy and water:
How effective is your board in delivering ‘future customer’ and wider stakeholder outcomes?

A Sustainability First check-list for
energy & water board effectiveness

Annexes 5-6

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Annex 5: Key findings, different perspectives and case study insights from elsewhere

5.1 Developing shared future narratives for the sectors
5.2 Relationships
5.3 Investor commitment and business models
5.4 Engagement
5.5 Walking the talk – reporting and assurance
5.6 On board – board composition

The insights from elsewhere were cited by interviewees as being potentially relevant to the energy & water sectors

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Annex 5.1: Developing shared future narratives – Key findings

Ambiguous institutional landscape

Not always clear what direction of travel / hierarchy of objectives is and what pace of change should be. Responsibilities are divided between governments, departments and regulators (particularly in water). Makes consensus on desired future outcomes difficult

Complex group structures

Complex and hierarchical structures can make it difficult externally to understand who in company is responsible for strategy and values. This is often still the TopCo. Whilst it is normal to have parent companies, this is an issue if this means the licensed company has to work within a given strategy and mind-set that might be at odds with local needs and interpretations of fair play , or leads to concerns that profits are being 'hidden'

Leadership for the sector

Lack of ownership of the future – but some good examples where this is happening at a regional level; more difficult on a national basis. There is nothing in principle stopping more sector leadership / collaboration

Narratives fixed in time

Risk that policy and regulatory view of world is focused on most recent set of numbers or yesterdays problems. Takes time for their understanding to catch up with sector reality. Some described a limited appreciation that narratives need to evolve, particularly in dynamic environments facing transformational technical change

Annex 5.1: Developing shared future narratives - Different perspectives

It's not so much the words coming out of government that are important, it is the tone

A shared sector vision would be bureaucratic – companies have different issues

The FRC Corporate Governance Code doesn't help here. It's the imponderability of industry factors and the uncertain pace of climate change that is the issue

There was a constant reminder that Ministers were in charge of policy – not the regulator. But the Ministers changed regularly and there were different political views and personalities

It's not up to the regulator to set out the vision. It needs to be built together with stakeholders. Companies need to get used to the ambiguity of this reality

Developing a vision is an ongoing process

Companies can't individually produce the vision. There are facts driving the long-term outlook of the sector. Government & regulators have a role in getting a collective agreement on the facts. Companies need to develop their strategies within this context

Monopoly companies will always want clarity

Once the board thinks about the politics of it and thinks the government will bail them out, they can become passive

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Annex 5.1: Insights - Working together

Cabinet Office

Partnerships between Departments and Arms Length Bodies (ALBs), Code of Good Practice

- This Code, published in 2/17, covers purpose, assurance, values & engagement.
- It's proposals are relevant to the work of energy and water regulators
- Cabinet Office has said partnerships between departments & ALBs work well when relationships are 'open honest, constructive and based on trust' and when the purpose and objectives of ALBs are *mutually* understood

YJB Youth Justice Board

The Youth Justice Board

- The YJB works to prevent children and young people from offending / re-offending. It seeks to ensure custody is safe and secure
- The relevant professional services (the police, the probation service etc) have a statutory duty to co-operate
- '*Once these organisations realised that they had an agenda in common, they started working together in a different way*'

Annex 5.2: Relationships - Key findings

Culture

Relationships with regulators can be unduly adversarial. Many company board members do not feel that they can be open or pragmatic about problems. This can lead to unconstructive 'parent / child' or compliance approaches. It makes it more challenging for companies to create a dynamic culture that enables innovation and risk taking

Conduct

The ethos and values of government, regulators and companies need to be clearer and stronger to cope with ambiguity and ensure personalities and historic baggage don't get in the way. Boards do not give sufficient weight to leading by example in terms of conduct in their inter-actions with other stakeholders; internally and externally

Contact

Chairs and CEOs of regulators do make efforts to visit company boards. Even so, companies still feel that their interactions with regulators are often unduly 'formal.' This can lead to relationships becoming 'ossified'

Annex 5.2: Relationships - Different perspectives

A climate of confidence needs to be developed

Tensions between different agencies need to be explored in a transparent way. Need to be open about the choices that are being made

From a governance perspective, need to be comfortable with 'contained' failure

We need more mature relationships. To move from the simple world of the past & the old parent-child culture

The regulator needs to use a complex set of governance tools to signal changes in the direction of travel to get cultural change

The corporate form is not naturally open

At the end of the day, you can only do so much with governance law. The key thing is how people behave and whether they do things in line with their values

Co-creation and co-delivery are the name of the game – we need a culture to support this

Regulators only get the right answers if they ask the right questions

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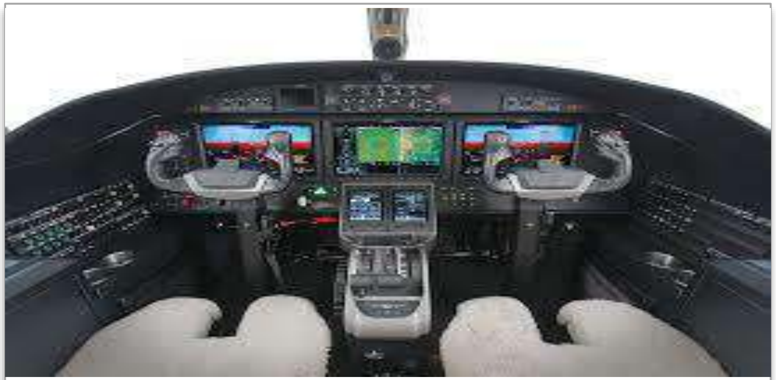
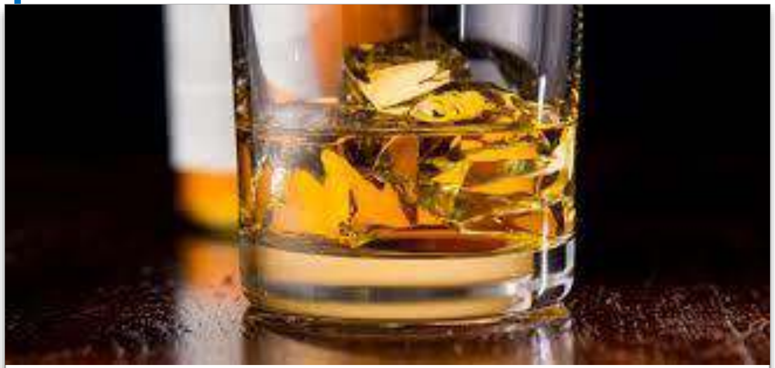
Annex 5.2: Insights from other sectors – Sector co-operation



US Aviation Safety Reporting System

- Airlines have a joint interest in air safety
- The ASRS is a voluntary confidential reporting system that allows pilots and crew members to share near misses & close calls. These are then analysed to reduce the likelihood of future accidents
- Run by NASA, a neutral party, this gives reporters confidence to come forward
- Used as a model for co-operation on risk management in other sectors
- Is safety a special case? Could long-term public interest outcomes in energy & water be another area for co-operation?



Scotch Whisky Association

- The market for Scotch Whisky is competitive, yet producers recognise that they have a joint interest in Scotch Whisky's long-term growth
- The Association works to safeguard the Scotch Whisky category worldwide
- There is an understanding that all companies will prosper if they collaborate in this way; *'They know when they need to be friends'*
- The Council is governed by 12-16 members; senior figures in the industry
- Regulators may have views on this one!

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Annex 5.3: Investor commitment and business models - Key findings

Time horizons

Periods of commitment are key. Some investors invest in-perpetuity and their interests are clearly aligned to maintaining the assets and sustainability of the company. It can be difficult for investors with shorter periods of interest to demonstrate how they are fulfilling Section 172 of the Companies Act 2006 and their stewardship responsibilities

Understanding risk in the sectors

Investors looking for stable returns need to understand the political risk and climate and technological uncertainty facing the sectors

Overseas investors

Overseas investors may be more focused on serving investors and 'the public' in their home country rather than UK consumers. This is not always the case. Some regulated businesses make systematic efforts to engage the public in their areas of activity / operation

Annex 5.3: Investor commitment and business models - Different perspectives

Risk assessments around climate change aren't yet being translated into changing business models and decisions around existing investments

If investors are waking up to the ambiguity of these sectors that's a good thing

For long-term investors, it's not about growing the asset base but about making sure it doesn't get smaller. For asset based businesses, issues of scale are a significant risk

The small shareholder tail isn't really an issue in energy and water

Asset stewardship is not seen as the day job. They are not thinking in terms of asset life cycles

Some companies spend all their time talking to their pension fund investors... but not all

Annex 5.4: Engagement– Key findings

Systematic stakeholder engagement?

In some companies engagement is deeply embedded and is shaping board decisions. In others, it is a compliance activity that rarely touches the board; especially if there is a TopCo. Not always clear where engagement has made a real difference to board

Active consumers

Some boards still see consumers as passive and in extremis part of the 'problem' not the solution. Governance processes have not really adapted to an active – and digital - consumer world. In the past, capacity for consumers to make major changes has been limited by boundaries regulator has set for consultation in price reviews – this is starting to change

Acceptability of services

Some limited recognition that stakeholder engagement can help boards frame & deal with conflicting interests & provide a 'mandate' for progressing difficult issues, helping to make these stick and ensure services (and prices) are more acceptable and political risk is better managed

Collaboration & partnerships

Limited thinking on how governance may need to adapt in practice to take partnerships and new local, community and regional approaches into account. Concern from some that co-creation of the vision with existing consumers may 'bake in' existing ways or doing things

Annex 5.4: Engagement - Different perspectives

More formal consumer challenge has changed the tone and tenor of debate in companies

To rely on individual companies engaging with consumers on big issues of cross subsidy is naïve

Dialogues between customers, stakeholders and companies can lead to agreement on most issues. It is when it gets out of the 'room' and is operationalised that it can become political and start to unravel

If consumers are only engaged in 'marginal' issues, why will people want to continue to be involved in a formal process?

When board puts in time to help the consumer panel understand, it delivers benefits & reduces regulatory risk

Engagement gives a mandate to the political side to go ahead with change

The information asymmetry is so great, consumers can't really be expected to co-create solutions, except around the edges

The regulator needs to frame the engagement and play a role in creating different conversations

Annex 5.5: Walking the talk - Key findings

Committees

There are still differences between company approaches to board reporting/assurance on public interest issues. Corporate Responsibility, Ethics & Customer Committees can give more time to long-term public interest issues. However, still used by only a minority of companies. Some are sceptical that these are 'bolt on'

Reporting periods

Many board members interviewed considered that their reporting was primarily based around regulatory cycles rather than longer-term planning periods (that major infrastructure / resource related investments may require). Extent to which good will / going concern assessments reflect long-term position varies

Measuring long-term public interest

Agreement on importance of building an evidence base as to what constitutes long-term public interest. Although some interest in Natural Capital Accounting, limited practical application. Water UK's 'Discover water' dashboard enables consumers to compare some performance between companies (as yet no equivalent for energy). However, still difficulties in developing KPIs/Management Information on longer-term public interest outcomes

Common language

Different stakeholder groups use different language and terminology (eg around stewardship). This can lead to misunderstanding and mean corporate communications & reporting don't always 'hit the mark'

Annex 5.5: Walking the talk - Different perspective

What gets measured is what gets done…engagement needs to be measured and this needs to cascade upwards into the business plan

Quality of the evidence base is key to making decisions….the evidence base needs to capture hard as well as soft information

Corporate responsibility needs to be core to the company's social purpose. The CEO needs to be involved

It is still not clear what the data set is that demonstrates that the board understands the short and long term interests of the company

CSR is a weak lever & is largely still project related

The public can define the long-term public interest. It's operationalising it that is the issue

Corporate responsibility is the closest you get to having a strategic discussion on the long-term public interest at board level

Annex 5.5: Insights - Reporting and assurance

Enhanced / well justified business plans

- Fast tracking introduced in last price controls
- Boards recognise importance of building an evidence base for business plans to be fast tracked
- Companies need to explain their choices to the regulator and communicate in a compelling way why they are doing what they are
- Increasing recognition stakeholder views need to play a part in building the evidence base
- Fast tracking can directly reward management teams and give investors earlier certainty
- However, jury is still out amongst regulated companies on the impact of fast tracking and whether it builds or undermines trust
- Some companies content to be 'good enough.' Others may not want to put heads 'above parapet.' Companies wishing to do something different unlikely to seek fast tracking

GAMBLING COMMISSION

Pilot of annual assurance statements

- The Commission is piloting these with some license holders
- Statements are designed to improve focus on accountability for the delivery of license objectives by the board
- Self assessment of the risks to the licensed objectives posed by the business

Annex 5.5: Insights - Good governance examples

BUSINESS IN THE COMMUNITY

BITC's 2016 Corporate Responsibility Index Insights Report

- Although companies have to choose & then pay to be part of the index, it provides a good example of what can be done in this area
- Three energy and three water companies are featured in the 2016 Report. Kelda group gained the highest utilities score - a 4.5 out of 5 star rating measuring how integrated CR is in its business strategy and operations
- Report looks at megatrends impacting companies, importance of vision & values, trusted leaders, supply chains and measuring the value of responsible business

tomorrow's company

The Tomorrow's Company approach

- A purpose beyond profit and set of values that are lived through the behaviour of all employees to create a self reinforcing culture
- Collaborative and reciprocal relationships with key stakeholders – a strong focus on customer satisfaction, employee engagement and, where possible, collaboration with suppliers, alongside working with society
- A long-term approach that embraces risk – investing long-term and embracing disruptive innovation

See slide 59 for other groups active in this area

Annex 5.5: Insights - Pensions

NEST
NATIONAL EMPLOYMENT SAVINGS TRUST

Nest Corporation

- Nest was set up by Government as part of the pensions Auto-enrolment programme. It is run by an independent Trustee
- Nest has a Members' Panel that participates in the appointment of new Trustees & produces an Annual Report
- Nest also has an Employers' Panel
- Both panels are consulted when the Statement of Investment Principles is reviewed – one of the Corporation's key documents

Independent Governance Committees

- The FCA requires firms that operate workplace personal pension schemes to have IGCs
- IGCs act solely in the interests of relevant scheme members and are independent of providers
- The majority of members, and the Chair, are independent
- IGCs have a duty to scrutinise the VFM of the provider's schemes – when appropriate, making recommendations to the provider's board

Annex 5.6: 'On board' - Key findings

Range of interests

The full spectrum of the organisation's long-term interests is not necessarily reflected by individuals on company and regulatory boards. Many companies appoint executive directives largely from within. Many INEDs on network company boards come from a relatively small 'regulation pool.' Individuals representing consumer / public interests tend to come from regulated bodies in other sectors; environmental interests are rarely directly represented . Strong view that experience more important than 'representativeness'. Risk that as relative insiders, INEDs sucked into the detail rather than asking big questions

Role of INEDs

Differing views as to the role of INEDs; are they there primarily to protect the regulatory ring fence or to provide independence? Many INEDs see one of their main challenges as translating the public interest agenda into the language of a non-regulated company. This can be done through a focus on risk and resilience. The role of INEDs is also starting to evolve in response to more formal consumer engagement processes

Annex 5.6: Insights - Independent perspectives

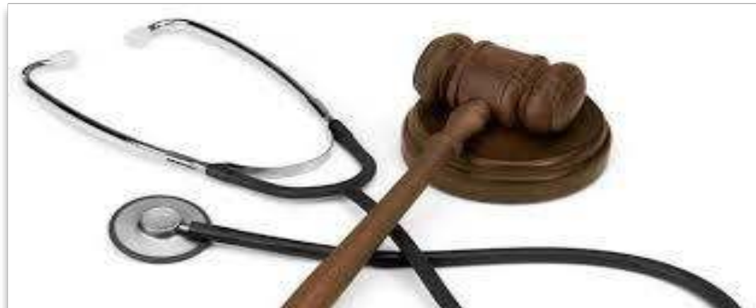
NHS

Foundation Trusts

- The 'Governors' are there to represent different voices eg local people. They formally appoint the Chair of the Trust
- Governors play a key role in terms of acceptability of the service
- Governors can play a positive role in Committees; asking 'killer' questions
- Concerns re clarity of role & support?

Sustainability and Transformation Plans

- Changes in governance 'kick started'
- Regulatory framework makes clear significant financial savings needed
- A mixture of carrots and sticks used
- Where change has worked, often due to fact embraced by professionals



The professions

- Regulators in the professions now routinely have 'lay' members on their Boards (eg the General Medical Council and the Solicitors Regulation Authority) - including lay chairs
- Lay members play a full role in Board meetings
- They provide an independent and external perspective and help avoid group think
- Lay members can help explain the purpose of the regulator and the reasons for decisions

Annex 6: UK corporate governance – a potted history

1992 - Cadbury Report: led to Corporate Governance Code for listed companies Code covers board leadership, effectiveness, accountability, remuneration & relations with share holders

2003 – Higgs Report gave responsibility for the Code to The **Financial Reporting Council (FRC)**

2006 Companies Act: Section 172 States that in promoting the success of the company, directors should take account of range of stakeholders & consequences of decisions long-term

2010 – FRC Stewardship Code Stewardship promotes long-term success of companies so ultimate providers of capital also proposer. Code requires investors to disclose policies on how discharge responsibilities, manage conflicts etc

7/2016 – FRC Report on Corporate Culture and Role of the Board The value of culture, leadership, openness, embedding values etc

11/2016 – BEIS Corporate Governance Reform Green Paper Covered strengthening the employee, customer and wider stakeholder voice as well as governance in large privately held businesses (so **not** just listed companies)

2/2017 – FRC Stakeholder Panel to Review Corporate Governance Code Panel established

8/2017 Corporate Governance Reform – Government Response See next slide

Annex 6: The corporate governance landscape – the bigger picture

- Twenty five years after Cadbury, there remains a growing concern that many UK companies across the economy still give too much weight to short-term goals and interests
- There is a widespread feeling that the governance lessons from the 2008 financial crash have not yet been fully taken on board in this regard and in areas such as Senior Executive Pay, risk appetite etc
- Active Government interest in corporate governance reform for all sectors of the UK economy is now building
- Following the Corporate Governance Green Paper last November, in August 2017 the Government issued a response. They intend to:
  - Introduce secondary legislation to require **all** companies of significant size to explain how their directors comply with the requirements of section 172 of the Companies Act to have regard to employee and other interests;
  - Invite the Financial Reporting Council to consult on the development of a new Code principle establishing the importance of strengthening the voice of employees and other non-shareholder interests at board level; and
  - Encourage industry-led solutions by asking ICSA (the Institute of Chartered Secretaries and Administrators: The Governance Institute) and the Investment Association to complete their joint guidance on practical ways in which companies can engage with their employees and other stakeholders
- Specialist NGOs and other groups are active in this area; these increasingly work through global good governance networks that mirror global capital
- This is likely to have an additional impact on governance in the energy and water sectors and may 'frame' how this is perceived by the public
- Water and energy company boards can use our Sustainability First effectiveness check-list to assess how they are likely to meet the new corporate governance expectations

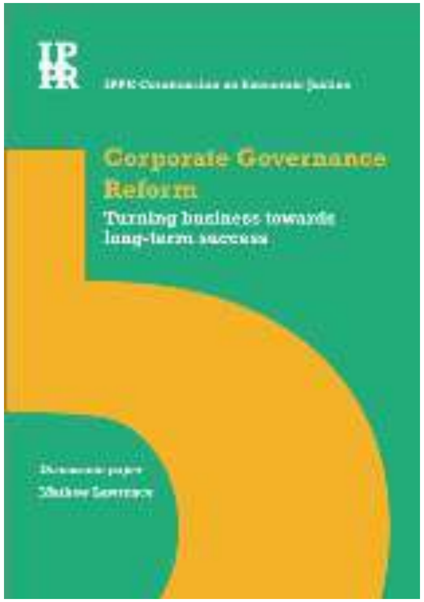
Annex 6: Examples of *some* of the specialist groups and NGOs active in corporate governance

BUSINESS IN THE COMMUNITY

ibe
Institute of Business Ethics

ShareAction
the movement for Responsible Investment

Dow Jones
Sustainability Indexes



PRI Principles for Responsible Investment

TRANSPARENCY INTERNATIONAL

tomorrow's company

ICAEW

CDP
DRIVING SUSTAINABLE ECONOMIES

Sustainability *first*

For further information about Sustainability First, New-Pin or to get involved in our forthcoming project on ‘**public interest compacts**’ for energy and water companies, contact

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