

David Andrews
Financial Reporting Council
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By email to d.andrews@frc.org.uk

Monday 9 January 2012

Dear Mr. Andrews,

FairPensions welcomes this opportunity to respond to the consultation, *'Proposals to reform the Financial Reporting Council'*.

FairPensions is a registered charity that promotes Responsible Investment (RI) by pension schemes and fund managers. We also work with policymakers to improve transparency and accountability to savers, and to remove regulatory barriers to RI. We are a member organisation whose members include representatives of pension savers (such as the National Federation of Occupational Pensioners, UNITE and Unison), a number of leading UK charities (including Oxfam, Amnesty International and WWF), and thousands of individual pension fund members.

We comment below on the questions and issues which have relevance to our remit.

1. Do you have any comments on the case for FRC reform as set out in this document?

The consultation paper notes that 'the scope of the FRC's regulatory activities is not sufficiently clearly defined'. We believe that greater clarity is needed about the FRC's mission and objectives if the reforms are to have the desired benefits in overcoming this problem.

We are concerned that the framing of the FRC's mission in the consultation paper is too narrow and unduly privileges the interests of investors, rather than the public interest in good corporate governance which should be the FRC's ultimate concern. We appreciate that this framing does not reflect a change in the FRC's mission; nonetheless, in the context of efforts to reform and streamline the FRC, it would seem important to consider whether it remains appropriate.



The consultation paper states that the FRC is responsible for “promoting high quality corporate governance and reporting to foster investment” (emphasis added). This formulation is reflected elsewhere in the document, for example in the proposal that the FRC should set standards for governance, accounting, audit and actuarial work “in the interests of investors” (Executive summary), and the statement that the FRC should “effectively challenge failure to meet the standards of behaviour expected by investors and in the capital markets” (p8, emphasis added).

We have two concerns about this formulation. Firstly, it is unclear what is meant by the term ‘investor’. In our experience, this is generally interpreted as referring to the professional asset management industry, and, to a lesser extent, its major institutional clients. It is often forgotten that these actors are themselves intermediaries acting on behalf of individual savers and investors. Therefore, the interests and expectations of the investment industry should not be the sole determinant of the FRC’s regulatory approach. Indeed, as has been recognised with the development of the Stewardship Code, part of the FRC’s role is to ensure that investors themselves are fulfilling their governance responsibilities in the interests of their beneficiaries.

Secondly, there is a more fundamental problem with equating the public interest, which the FRC must serve, with investors’ interests. Again, the Stewardship Code arose from the recognition, articulated in the Walker Review, that there is a public interest in good corporate governance, and that where investors fail to defend this interest – as they did prior to the financial crisis in relation to major banks – it is legitimate for regulators to step in. There is little room for this recognition in a formulation of the FRC’s objectives which focuses exclusively on the interests of investors.

In taking responsibility for developing the Stewardship Code, the FRC accepted the Walker Review’s recommendation that “*the remit of the FRC should be explicitly extended to cover the development and encouragement of adherence to principles of best practice in stewardship by institutional investors and fund managers*”. The current framing of the FRC’s mission does not reflect this evolution. We therefore suggest that this framing should be reconsidered as part of the current process of reform.

In summary, we are concerned that framing the FRC’s objective solely in terms of ‘fostering investment’ excludes important parts of its remit and risks undermining the objectives of reform, including greater clarity about the scope of the FRC’s activities, and the desire to enhance the FRC’s independence from regulated entities.

8. Do you agree that streamlining the FRC’s governance and structure will bring the benefits described?

9. Do you have any comments on the proposed reformed FRC governance and structure?

Broadly speaking, we agree – although, as discussed above, we believe this may not fully achieve the desired benefits without greater clarity about the FRC’s mission and objectives. In particular, we hope that the new structure will provide clearer lines of accountability for the new advisory councils than are currently in place for the FRC’s various boards and panels.

It is vital that the principle of independence is embedded across the new structure. Our experience relates primarily to the Financial Reporting Review Panel and it is on this that we focus our comments, although the general points may have wider applicability.

We welcome the FRRP's recent focus on improving the quality of narrative reports. However, we are concerned that these efforts are still not proportionate to the scale of the problem. The Accounting Standards Board's own research found that two thirds of companies fell short in their reporting of principle risks; over half fell short in their description of the business; and one-third were non-compliant with legal requirements on non-financial KPIs. Yet action from the FRRP against non-compliant company reports remains extremely rare. We believe there are three underlying problems which could be addressed as the FRC moves towards a new structure:

- *Transparency.* Whilst we understand the desire to avoid negatively impacting a company's share price by disclosing details of an investigation before wrongdoing has been found, we do believe there is significant scope for the FRRP to be more transparent in its activities. At present, lack of transparency is impeding the effectiveness of FRC regulation. If more was disclosed about individual cases, this would help to drive up standards across the board by providing a body of experience about what is and is not acceptable reporting. At present this body of information is simply not available to the market.
- *Resources.* The FRRP should have sufficient resource to investigate company reports proactively, rather than relying on complaints from investors or NGOs (such as the recent complaints by ClientEarth in respect of BP and Rio Tinto's annual reports).
- *Independence.* The FRRP's membership should include a significant number of experts who are fully independent of those it regulates – for example, drawn from the community of report users such as investors and civil society. They should also ensure they have the breadth of expertise necessary to assess compliance with *all* narrative reporting requirements in the Companies Act. For example, since non-financial KPIs were the single largest area of non-compliance uncovered by the ASB, the FRRP should make it a priority to ensure that it has specific expertise in the reporting of environmental, social and governance (ESG) risks and KPIs.

These three tests – transparency, resources and independence – could usefully be applied to all of the advisory councils which are due to replace the current boards and panels.

In relation to independence, we note that one of the described benefits of the new structure is a more effective voice for the FRC at EU and international level. It is vital that the FRC's exercise of this voice is rooted in its status as a public interest regulator, and not as a representative of the investment industry or the UK corporate governance community. In this context, we refer again to our comments above regarding the framing of the FRC's mission and objectives.

14. Should the FRC be able to take more proportionate, nuanced action against a Recognised Supervisory or Qualifying Body and therefore be given a wider range of enforcement powers against the recognised bodies?

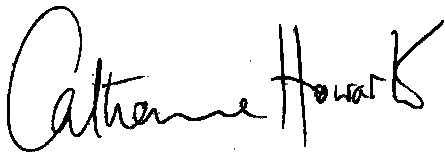
Yes.

16. Do you agree that the FRC should develop a mechanism to enable it to undertake supervisory inquiries into matters of concern, either of individual market events or wider market interest, initially building on its current powers to secure information?

Yes.

We would be pleased to meet with you to discuss any of the issues raised in this response. If you have any questions, please contact our Policy Officer, Christine Berry (christine.berry@fairpensions.org.uk / 0207 403 7833).

Yours sincerely,

A handwritten signature in black ink that reads "Catherine Howarth". The signature is written in a cursive style with a large initial 'C' and a stylized 'H'.

Catherine Howarth
Chief Executive, FairPensions