FRC Financial Reporting Council

Sir Winfried Bischoff
Chairman

The Rt Hon. the Lord Hill of Oareford CBE
Commissioner for Financial Stability,
Financial Services and Capital Markets Union
European Commission Rue de la Loi /
Wetstraat 200 B -1049 Brussels
Belgium

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Dear Commissioner,

CALL FOR EVIDENCE: EU REGULATORY FRAMEWORK FOR FINANCIAL SERVICES

The Financial Reporting Council is following closely the progress made in establishing the scope and application of the Capital Markets Union (CMU) which we believe will help foster investment throughout the Union and help to return strong growth to European economies.

We welcome the Commission's call for evidence which is consistent with our own approach to our mission of fostering investment. We achieve that goal through promoting high quality reporting and audit which gives confidence to investors and thus contributes to growth. We believe we are better able to improve quality by encouraging best practice and collaboration rather than imposing more rules.

The work of our Financial Reporting Lab, which we talked about when we met in February last year, is an important part of our strategy. It has been a successful tool in addressing the concerns of investors and the market by working directly with them to find solutions that do not necessarily require direct regulatory intervention. We would recommend that a similar, investor driven, approach be utilised by the Commission in dealing with the issues identified by the call for evidence and CMU action plan.

Our response has three cross cutting themes which we believe may help to address one of the problems identified in your call for evidence – that the cumulative impact of individually sensible policies can be incoherent and create unnecessary complexity. We also make a specific recommendation for the Commission to have a closer look at the reporting and auditing requirements for subsidiaries.

Inconsistent reporting thresholds/definitions (for example, of public interest entities) in EU law should be avoided where possible.

Thresholds and definitions are critical to ensure legislation is both proportionate and effective. To avoid disproportionate regulation and complexity, the Commission should review whether they are applied consistently in legislation with the same objectives.

8th Floor, 125 London Wall, EC2Y 5AS **Tel: +44 (0)20 7492 2300** Fax: +44 (0)20 7492 2301 www.frc.org.uk
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For example, the core objective of both the Non-Financial Reporting Directive (NFR) and the Accounting Directive (AD) is to promote transparency but they employ different thresholds: the former applies a threshold of 500 employees to PIEs [as defined in Article 19a & 29a (Consolidated) Directive 2013/34/EU], whereas the latter has no threshold [Article 2 (i)]. This means some companies which are not captured by the NFR are subject to regulations in the AD with no clear rationale. We encourage the Commission to look more closely at the inconsistent application of definitions and thresholds within the accounting regime and also to review whether such inconsistencies exist within other areas of EU regulation.

A first step in creating consistency may be to work with Member States to gather the necessary evidence of impact. We should err on the side of reducing complexity and the starting assumption should be to use higher thresholds and narrower definitions as a means for more proportionate regulation.

EU reporting requirements that either duplicate or are inconsistent with overlapping requirements in international accounting standards should be stripped out.

There are disclosure requirements in EU legislation that are similar to those in IFRS but whicih could result in different outcomes; one such example is the requirement in IFRS to disclose principal subsidiaries, whereas the AD requires disclosure of all subsidiaries. While recognising the need for further analysis to consider the rationale for the differing requirements on a case by case basis, the starting assumption should be that they should be made consistent.

The implementation periods for EU legislation (including that introduced by the ESAs) should be extended to three years, where appropriate.

The Treaty on the Functioning of the European Union and the drafting guidelines provide that the transposition date should be agreed during the legislative process, to account for the specific situation or sector. In limited circumstances, it may be necessary for urgent implementation of legislation, as seen during the 2007 financial crisis. However, there is now less need for urgency and more need for proportionality and effectiveness.

The inter-institutional 'Joint Practical Guide for persons involved in the drafting on European Union legislation' states that deadlines for the transposition of legislative acts must 'guarantee an adequate period for transposition'. It is the experience of the FRC with the implementation, for example, of the AD, the Transparency Directive and the Statutory Audit Regulation and Directive, that the two year transposition period within these initiatives is not always adequate.

In our view, a three year implementation period would be more suitable. It would reduce transitional costs, make business compliance more effective and can be achieved within the existing framework for legislation.

We also believe that extended implementation periods would improve Member State implementation and transposition by allowing for proper due process with more extensive consultation where necessary and improved impact assessments.

Review the cumulative impact of assorted reporting and auditing requirements relating to subsidiaries.

Our discussions with market practitioners in the UK have identified potential for deregulation in this area as well as for removing inconsistencies in regulations. We believe it serves as a

good example of the unintended consequence of sensibly derived individual policies that when taken together result in an overly burdensome reporting regime.

We recommend the Commission look at the pros and cons of making the overall regulatory framework for subsidiaries more proportionate by easing the burden of reporting and auditing on non-principal and non-PIE subsidiaries. One way to approach the subject would be to use a market led initiative such as the Company Law Expert Group (which, we understand, has been looking at the related topic of group interest). This approach could address any concerns of investors as well as the burdens on companies.

Two examples of where there may be scope for reducing the burden of regulation would be to consider loosening the restrictions on parent companies electing not to require an audit of a subsidiary where it is not material to the group and, as mentioned above, aligning the reporting requirements in Article 17 of the AD with those in IFRS so that companies are not required to list subsidiaries that are not materially significant to the group structure.

I hope these suggestions may be helpful in your very worthwhile initiative.