Aviva response to the FRC Draft Plan and Budget

1) Do you have any comments on the proposed priorities and engagement strategy outlined above?

Aviva places a strong premium on corporate governance and we welcome the FRC's focus in this area, we would like to see the FRC continue to provide leadership on corporate governance and we welcome particularly the recent paper on explanations, which the FRC engaged effectively with key stakeholders on.

Like the FRC, we believe non-financial reporting is essential for sustainable growth. Considering and reporting on environmental, social and governance (ESG) information is a management tool that helps business to perform better and create more sustainable value over the long term. Extensive evidence exists to suggest that measuring and therefore reducing the environmental and social impact of business operations is linked to corporate success. For example, Goldman Sachs analysis has indicated that there is direct correlation between sustainable business practices and the longer-term financial success of a company in a number of sectors.

The production of ESG information creates the right kind of discussions within boardrooms, throughout firms and encourages investors to think about the sustainability of the firm as well as analysing risks and opportunities presented by environmental, social and governance factors. It also helps capital to be allocated to more sustainable, responsible companies and strengthen the long term sustainability of the financial system.

We therefore believe that the promotion and regulation of narrative reporting should be a top priority for the FRC. In the upcoming EU Accounting Directive we would like to see regulation on non-financial reporting that:

1. Encourages boards to use their reports and accounts to debate the issues and potential consequences for their company and either **comply** by disclosing or **explain** why they have not.
2. Focuses on issues that are **business relevant** and potentially material.
3. Builds on and refers to **existing guidance**, including but not limited to the UN Global Compact, Universal Declaration of Human Rights, Global Reporting Initiative, ILO Core Labour Standards, OECD Guidelines for Multinational Enterprises, , CDP, CDSB, ISO standards and International Integrated Reporting Council.
4. Focuses on the disclosure of corporate performance, with **quantified key performance indicators**. It shouldn't just require one-off policy statements.
5. Requires sustainability KPIs to be **integrated** throughout the report and accounts, including strategy, risk, audit and remuneration.
6. Ensures **market oversight** via the annual report and accounts that should be tabled at the AGM.
7. Applies to all companies with a **market capitalisation of at least €2bn**.

We would like to see the FRC ensure that this European legislation encourages considered and meaningful disclosure.

In relation to the Corporate Governance Code, we believe that further developments of the Code should include:

- The remuneration of executive board members and throughout the organisation should in part be determined by how well they live the culture and standards of the company. Individuals should suffer the consequences of not meeting the company‟s expectations by having their remuneration scaled back. In some situations, it may be appropriate for employees to be dismissed.

- Boards should ensure they are reassured that Audit and risk committees are not focused just on the most expedient considerations for the short term e.g. doubtful accounting approaches but focused on the long term interests of the company.

- The approach to culture and ethics in succession planning, board evaluation and the processes around facilitating this culture throughout the business should be disclosed and transparent.

- Proper, externally managed whistle-blowing processes should be available to staff.

We welcome the commitment to define exactly what is meant by stewardship and to build support for this vision and we particularly welcome the commitment to clarify the contribution that is and should be made in each part of the investment chain to stewardship. This forms part of the debate that has been opened by the Kay Review, which is positive. Professor Kay produced a thorough and thoughtful analysis of the causes of short-termism in the equity markets and his recommendations to expand and clarify fiduciary duties, to reinvigorate collective engagement, and to establish a new investment forum for this purpose with a wide membership were particularly welcome.

However we were disappointed that the study did not examine more deeply the role of other participants in the investment chain that have a huge influence on the way companies are structured and develop their strategies - particularly sell side brokers. It also missed the opportunity to encourage investment consultants to oversee the way asset holders and their managers engage in stewardship. Not providing recommendations that address all the participants that influence the investment chain, or the inherent tensions and commercial conflicts, means the report failed to address the underlying causes of why the market is so short term.

We would like to see the stewardship code extended to investment consultants, sell-side brokers and asset owners on a comply or explain basis and we would like to see the FRC working with the Pensions Regulator and other relevant bodies to promote understanding of the stewardship code across the investment chain. Furthermore, we believe that proxy agencies should be required to disclose conflicts of interest, but that regulation beyond that could be anti-competitive in an area which already has oligopolistic characteristics.

2) Do you have any comments on the activities outlined above?

Building on the work of the Kay Review is absolutely vital to further corporate governance and stewardship in the UK. As stated in question one, we believe the stewardship code should apply to asset owners. We also believe that the financing of long-term stewardship research should be considered given that this was also absent from the Kay Review. His analysis assumed that fund managers will be responsible and accept their public interest role for them to conduct stewardship and voluntarily invest more in their stewardship work. This is misguided at best and economically naive at worst. Unfortunately, without demand from beneficiaries and a financial funding solution, the scale of investment stewardship will be piecemeal and disproportionately low.

A few fund managers - including Aviva Investors - direct research commission towards brokers and independent research providers of long term investment research, voting advice and stewardship work. We are clear that such investment in stewardship adds value to investment decisions and is in the long term interests of our clients. However, this approach remains uncommon and those fund managers that do utilise this mechanism tend to spend only a few percentage points of their research commission in this way.

We believe that if the FCA were to take the following four steps, then it would significantly increase the scale of stewardship resources in the market and fundamentally transform the delivery of long term investment analysis and investor stewardship:

1. The FCA could clarify that long term investment research that is orientated towards good stewardship behaviour by investors can be paid for in this way;

2. The FCA could suggest as a guide that it is good practice for a material proportion of the commission research (say 10-25%) to be spent in this way;

3. The FCA could say that it is good practice for fund managers to be transparent to their clients that this was taking place; and,

4. The FCA could say that it is good practice for clients to be allowed to opt out of this, as long as they are clear to their beneficial owners what their rationale is for so doing.

We also welcome the intention to report on good practice in board evaluation and the review of corporate reports. We believe that the FRC should also consider reporting on good practice in narrative reporting and the possibility of developing a benchmark and ranking by sector.

And we support the commitment to work with international investors. Subject to further work on financing, we support the concept of an Investors Forum.

3) Do you have any comments on our draft Budget 2013/14?

We welcome that the FRC is seeking to increase resources to enhance work in setting codes and standards for corporate governance and reporting.