

Feedback Statement and Impact Assessment

Post Implementation Review of the 2016 Auditing and Ethical Standards

Dated 15 July 2019

Response from Santander UK Group Holdings plc

Overview

1. Santander UK Group Holdings plc (Santander UK) notes the responses received by the Financial Reporting Council (FRC) as a result of its November 2018 Call for Feedback in relation to the 2016 UK Auditing and Ethical standards (the Standards) and welcomes the opportunity to comment on the FRC's proposals to amend these Standards (the Consultation). Santander UK notes that the FRC's key objective in this regard is to enhance confidence in external audit and we agree that it is critical for external auditors to be both independent and seen to be independent.
2. Santander UK is a wholly owned UK subsidiary of Banco Santander and is a public interest entity (PIE) as defined by EU law. It is required under the Companies Act to have its annual accounts subjected to an external audit. As a result, Santander UK would consider itself an interested party with regard to certain of the proposals the FRC is consulting upon.
3. In the following paragraphs, Santander UK has commented in relation to Questions 1, 2 and 4, specifically in relation to those areas of particular relevance to us. The other questions raised by the Consultation are less pertinent to us and we are therefore not in a position to comment.

Question 1: Do you agree with the revised definition of an 'objective, reasonable and informed third party' and with the additional guidance on the application of the test.

4. Santander UK supports the proposal to implement a stronger objective, reasonable and informed third party test and agrees that assessment should be made from the perspective of an informed investor taking into account the views of an entity's principal stakeholders so as drive diversity of thought. Santander UK currently assesses the threats to independence, objectivity and integrity in relation to interactions with our external auditors and welcomes the further guidance from the FRC in this regard.

Question 2: Do you agree with our proposed measures to enhance the authority of Ethics Partners and do you believe this will lead to more ethical outcomes in the public interest?

5. Santander UK has two observations in relation to the proposed requirements to make certain disclosures to those charged with governance as follows.
6. Firstly, and in relation to the proposed disclosure of where an audit fee does not cover the full cost of an audit engagement, Santander UK assumes that part of the rationale for this proposal is to prevent audit services being provided at a 'loss' with an audit firm looking to seek recovery

through the provision of non-audit related/additional services. We would note in this regard that whilst conceptually there is a resulting risk of the impairment of objectivity, integrity and independence, under the 70% cap, which we further comment on below from paragraph 11, this risk is reduced. We consider that the onus should be on both the external audit provider and the corporate entity to agree a level of fees that facilitates the delivery of a high quality audit.

7. We would also highlight the potential difficulties in measuring 'full cost'. Within Santander UK we consider fees charged to comparable clients within the same industry sector when benchmarking external audit fees and would therefore suggest that if disclosure is to be made in this regard, it considers fees which would be below the 'norm' for similar clients rather than on a fully costed basis.
8. Secondly, Santander UK would support the disclosure by an external audit firm of those instances where the firm has failed to follow the advice of its Ethics Partner. This would provide pertinent, additional information to take into consideration when an audit committee is assessing the quality and performance of its external auditor.

Question 4: Do you agree with the introduction of a permitted list of services which the auditors of PIE audits can provide?

9. Whilst Santander UK recognises that this proposal would create a framework for potentially delivering greater consistency of approach across PIEs and external audit firms, a move to a permitted list of activities aligned closely to audit or legal/regulatory requirements could prevent the external auditors from being appointed to provide services that, whilst not creating a conflict with their financial reporting responsibilities, they are best positioned to undertake from a knowledge/subject matter expertise and/or time/cost effectiveness perspective.
10. In making this representation, Santander UK has considered whether it would be practical to develop a 'white list' of services that could be provided by external auditors to retain an element of choice where there is no risk to the auditors independence, whilst still meeting the FRC's objective of restoring public confidence in the independence of auditors. We have concluded that this would very difficult to achieve and even clearly defining what is "closely related to the audit" or "required by UK law or regulation" would be difficult to achieve in a concise manner and therefore potentially open to interpretation. In addition, a 'white list' could result in a reduction in audit committee scrutiny as, if perceived to be on the 'white list', additional services could be deemed as automatically approved. We are therefore of the view that other potential solutions should be considered.
11. The Santander UK Audit Committee (the Committee) adopts a robust approach to the assessment and pre-approval of all services proposed to be provided by our external auditors or other providers where independence needs to be demonstrated (most recently with regard to the external firm appointed as Independent Expert in relation to the ring-fencing

requirements). The process is documented, subject to regular review and fully aligns to the requirements of the 2016 Standards. In addition to ensuring that any non-audit related/additional services do not comprise prohibited services, the safeguards in place to ensure independence and objectivity are identified and presented to the Committee. The Committee also voluntarily applies the EU's audit regulation 70% cap on non-audit fees, which the FRC has adopted in relation to UK PIEs (the Cap). Our voluntary application of this Cap is in advance of its formal implementation, which for Santander UK takes effect for the year ending 31 December 2020. Progress against the Cap is monitored at each Committee meeting.

12. We would therefore suggest that an alternative approach to achieve the FRC's objective of restoring public confidence whilst ensuring an element of 'controlled' choice is maintained, could be delivered through ensuring greater rigour is applied by the audit committees of all UK PIEs in ensuring that the appointment of the external auditor to provide non-audit related/additional services does not impair independence, integrity or objectivity in any way. This could build upon the 2016 Standards' existing list of prohibited services and could leverage the new powers being proposed by the Competition and Market's Authority to introduce greater regulatory oversight of audit committees.
13. As detailed in paragraph 11 above, our Committee has voluntarily adopted the application of the Cap in advance of its formal implementation date. Santander UK would also therefore suggest that, before implementing detailed changes to the rules permitting the appointment of external auditors to provide non-audit related/additional services, time is taken to understand the effects of this Cap on the provision of such services once implemented. There is a view that whilst not formally in force as yet, the cap has already resulted in a significant reduction in non-audit related/additional services being provided.
14. Consideration could also be given to reducing this Cap for UK PIEs to a figure below 70% as this would focus an organisation's decision making on those non prohibited services that add maximum value to the organisation from a subject matter/knowledge/efficiency perspective, rather than simply appointing the external auditor as the easiest/convenient option. Since voluntarily applying the Cap, Santander UK has not exceeded 40% and as reported in the Board Audit Committee Chair's report within the Santander UK 2018 Annual Report, the fees for non-audit work performed by our external auditor for 2018, other than those in relation to audit related services, were approximately 5% of the fees approved for the other Big-4 providers.
15. Other potential alternatives to the move to a permitted list of services would be to (i) introduce a high disclosure hurdle by both the external auditor and audit committee of any non-audit related/additional services that are not clearly identifiable as non-prohibited under the existing framework and/or (ii) expand the current remit of the Standards to place responsibility on both the external auditor and audit committee for ensuring enforcement in relation to the assessment of independence, objectivity and integrity in the appointment of the external auditor to perform non-audit related/additional services.

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16. Finally, Santander UK are of the view that these requirements should only apply to UK PIEs and their subsidiaries, rather than a parent company and its subsidiaries. It would be extremely onerous to determine from a UK governance perspective, if/what services would need to be provided by auditors in other jurisdictions.

Conclusion

17. Santander UK fully understands and agreed with the drivers behind the FRC's proposed amendments in relation to the appointment of the external auditor to provide non-audit related/additional services. We would however ask that alternative solutions, for example as highlighted above, are considered with a view to delivering the FRC's objectives whilst still maintaining an element of choice for a UK PIE to engage the external auditor to provide services where they are best positioned to do so and where there is no conflict from a financial reporting independence perspective.

26 September 2019