

Minutes: Investor Advisory Group

Date: 24 September 2018 @ 12:00-14:00

Venue: Financial Reporting Council, 125 London Wall, EC2Y 5AS

Lead: Stephen Haddrill, Financial Reporting Council

Attending:

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| Faith Ward | Brunel Pension Partnership |
| Michael Marshall | LGPS Central |
| Janice Turner | Association of Member Nominated Trustees |
| David Gorman | Castlefield Investment Partners |
| Andrew Cave | Baillie Gifford |
| Ben Yeoh | RBC Global Asset Management |
| Amra Balic | BlackRock |
| Natasha Landell-Mills | Sarasin & Partners |
| Kazim Razvi | Fitch Ratings |
| Mohammed Amin | Representing both UKSA and ShareSoc |
| Laurie Fitzjohn-Sykes | HSBC |
| Paul Marsland | Kepler Cheuvreux |
| Jen Sisson | Financial Reporting Council |
| Lydia Smith | Financial Reporting Council |

Apologies: Leon Kamhi – Hermes, Carine Smith Ihenacho - Norges Bank Investment Management, Simon Siu – BT Pension Scheme, Daniel Summerfield – USS, Jonathan Haymon – Institutional Shareholder Services

1 Welcome & Introductions

2 Review of Terms of Reference – IAG to agree minutes policy

- 2.1 The Investor Advisory Group (IAG) discussed how they would like the minutes to be set out.
- 2.2 The Public Summary will be circulated around the IAG members for approval before being published on the Financial Reporting Council (FRC) website.
- 2.3 It was discussed that the IAG should have a conflicts policy that each member should sign. Jen Sisson is to take this forward to produce a conflicts policy for the IAG members.

3 Revisions to the UK Stewardship Code

- 3.1 The aim is to consult on the Stewardship Code in December with a 12-week consultation period and publish the new code in summer 2019.
- 3.2 The aim is for the revised Stewardship Code to look at the full investment chain, including guidance for asset owners, asset managers, investment consultants, proxy advisors and others. The FRC plans to include specific reference to ESG integration and to consider extending the code to other asset classes in addition to listed equities. The FRC hopes to enhance the reporting requirements for the Stewardship Code to create a market for stewardship.

- 3.3 The IAG felt that there needs to be further clarification of the definition of an asset owner and asset manager in the code. It was noted that an institutional owner under the shareholder rights directive means the pension fund not the end beneficiary and the FRC clarified that the Stewardship Code is also aimed at institutional rather than individual investors.
- 3.4 The IAG were broadly supportive of the plan for the Stewardship Code to be specific of expectations across the whole investment chain and for expanding to other asset classes. However, there was less consensus on requiring information on stewardship to be disclosed at fund level versus at the organisational level. It was felt that teams and managers who think they are doing better are generally comfortable with increased reporting, but many organisations feel overwhelmed by reporting already.
- 3.5 On reporting, the IAG encouraged the FRC to consider what's useful to asset owners and investment consultants as they are the people using the statements and reporting of asset managers to make decisions.
- 3.6 It was then added that it is important that the Stewardship Code update takes into account the changing regulatory landscape.
- 3.7 The IAG encouraged the FRC to do more active outreach and education with the asset owner community to raise awareness of the importance of stewardship, help trustees to be comfortable with their role and help to create an understanding of the value of stewardship activities so that asset managers who want to do more don't get as much pushback from their clients.
- 3.8 It was also suggested that the new code should include stewardship of the system, not just the assets invested in, for example engagement with policy makers and on market wide issues.
- 3.9 It was also suggested that the FRC should seek to encourage a shift in resources towards stewardship.
- 3.10 There was some support for the Stewardship Code to follow the model of the UK Corporate Governance Code, with principles, provisions and guidance. The IAG commented that the FRC need to look at what best practice is and encourage more specific reporting on stewardship activities that are taking place while retaining the right balance between principles and provisions.

4 FRC transparency re investigations

- 4.1 The IAG discussed the paper prepared by the FRC setting out the rules under the Accountancy Scheme and the Audit Enforcement Procedure for public announcements.
- 4.2 The IAG generally felt that as market participants they would prefer to see the information out quicker to make a decision on it themselves rather than getting a court case and a fine a few years later.
- 4.3 The FRC clarified that the high court isn't used, but that the tribunal is a similar thing.
- 4.4 The FRC generally announce an investigation whether or not its been in the press. It was added that under the old scheme there was a higher hurdle to pass to bring in an allegation of misconduct.
- 4.5 It was stated that in the past a company could decide not to help in a case against an auditor by withholding information but now in the new scheme the companies are legally required to help the FRC.
- 4.6 A member of the IAG asked the FRC how decisions to begin an investigation are made. The FRC explained that opening an investigation can come as a result of a number of avenues, audit inspections or inspections on company accounts where the focus is on the company, but the FRC therefore also learn about the auditor. Other factors which can lead to investigations are whistle-blowing or complaints
- 4.7 The FRC noted that the Corporate Reporting Review team (CRR) now publish what accounts have been looked at, so investors can refer to the subsequent company annual reports to see the audit committees disclosure about the investigation.

5 Dividends and capital maintenance

- 5.1 The two main issues discussed were 1) how distributable profits are calculated and 2) what the FRC's role is in enforcing the law on dividend payments. It was acknowledged that the system is complex, and the FRC is one of many parties involved. The concern is that enforcement may be falling through the cracks, as no regulator is systematically checking that accumulated distributable reserve calculations are accurate.

- 5.2 It was noted that BEIS have announced that they are going to consult on dividend policies are forming a working group.
- 5.3 On the calculation of realised profits, members of the IAG expressed concerns that the current guidance is issued by the ICAEW, preferring the guidance to sit either in statute or be written by a body independent from the accountancy profession. There were also concerns raised about the definition itself, focusing on the ability to include accrued income in the calculations.
- 5.4 Some IAG members felt that the whole system needed to be overhauled, focusing on what the constraints should be on the ability of companies to pay dividends, including a discussion of pension deficit payments.
- 5.5 The IAG asked about the FRC's role in "policing" the dividend payments, and FRC staff explained that our work touches this area in both our Corporate Reporting Review and Audit Quality Review.
- 5.6 The FRC staff explained that there are requirements within the auditing standards for auditors to review compliance with laws and regulations, which would include compliance with s830 of the Companies Act.
- 5.7 The FRC are starting work on the responsibilities of the auditor based on going concern and viability to see if audit standards should require more of the auditor.
- 5.8 The IAG agreed that the system is complex and confusing in some areas, and that there isn't an overarching enforcement mechanism for the capital maintenance regime.
- 5.9 One IAG member raised concerns with the whole accounting regime, IFRS, which doesn't have capital protection as a goal. They commented that there needs to be an understanding of the different goals between the capital maintenance regime which is important for investors and the accounting standards, which will have to be the starting point for any calculation. The challenge is how to bridge this and how to make sure that whatever mechanism we have for bridging this is properly enforced. Several other members of the group voiced their support for this view.
- 5.10 A number of IAG members felt that a potential solution is to require additional disclosures to the market within the financial statements, which set out the realised profits of the group. Some IAG members believe this is already a requirement of the companies act. The FRC staff explained that there is no concept of Group distributable reserves, as the distribution test is at an entity level, but that historic FRC Lab work on dividend policy disclosures seems to be driving enhanced disclosures in the FTSE350 which should help with this concern.
- 5.11 It was added by the FRC staff that at the next FRC Board meeting a revised auditing standard will be approved looking at the audit of estimates and disclosures. This standard has been developed recognising that greater estimation is a feature of financial reporting framework therefore the standard has been significantly strengthened.

Action: FRC to consider next steps as a result of this discussion and update the IAG at their next meeting.

6 Open FRC consultations and projects

The IAG were alerted to the following open FRC projects and consultations:

[Consultation and Impact Assessment: Proposal to revise ISA \(UK\) 540](#)

[Consultation: Proposed Amendments to the FRC Taxonomies](#)

[Lab call for participants](#)